# SUPREME COURT OF THE UNITED STATES

## OCTOBER TERM, 1942

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## No. 972

## GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

## GOOCH MILLING AND ELEVATOR COMPANY

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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a [Caption omitted.]
1 Before United States Board of Tax Appeals

Docket No. 103993

GOOCH MILLING & ELEVATOR COMPANY, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Taxpayer: Ellsworth L. Fulk, F. W. McReynolds, J. Lee Rankin. For Comm'r: E. M. Woolf, Esq.; Angus R. Shannon, Esq.; J. M. Morawski, Esq.

*Docket entries*

1940

Aug. 1—Petition received and filed. Taxpayer notified. (Fee paid.)
Aug. 1—Copy of petition served on General Counsel.
Sept. 3—Answer filed by General Counsel.
Sept. 3—Request for hearing in Omaha, Nebraska, filed by General Counsel.
Sept. 9—Notice issued placing proceeding on Omaha calendar. Answer and request served.

1941

Mar. 17—Hearing set May 26, 1911, in Omaha, Nebraska.
Mar. 29—Notice of appearance of F. W. McReynolds, as counsel for taxpayer filed.
Mar. 29—Motion to transfer the hearing from Omaha, Nebraska, to Washington, D. C., filed by taxpayer.
Apr. 2—Hearing set April 23, 1941, on petitioner's motion.
Apr. 2—Copy of motion and notice of hearing served on General Counsel.
Apr. 17—Notice to send all notices to F. W. McReynolds filed by Ellsworth L. Fulk.
Apr. 23—Hearing had before Mr. Arundell on request of petitioner for Washington, D. C., calendar. (Set on Omaha, Nebraska, calendar.) Argued and denied.
Apr. 23—Motion for transfer to Washington, D. C., calendar filed by taxpayer. Denied.
Apr. 20—Motion for leave to file amended petition, amended petition lodged, filed by taxpayer.
May 3—Hearing set May 14, 1941, on petitioner's motion.
2 May 3—Copy of notice of hearing, motion and amended petition served on General Counsel.

May 14—Hearing had before Mr. Van Fossan on motion of petitioner to file an amended petition. Continued to Omaha, Nebraska, calendar of May 26, 1941.

May 14—Order of continuance to the Omaha, Nebraska, calendar of May 26, 1941, for hearing on motion at the same time proceeding is set for hearing on the merits entered.

May 26—Hearing had before Mr. Arnold on the merits. Submitted. Appearance of J. L. Rankin, Esq. Petitioner's brief due July 25, 1941. Respondent's brief August 25, 1941. Replies due Sept. 10, 1941. (Motion of petitioner to file amended petition. C.A.V.)

June 11—Transcript of hearing 5/26/41 filed.

July 9—Brief filed by taxpayer. 7/9/41 copy served on General Counsel.

Aug. 25—Brief filed by General Counsel.

Sept. 9—Reply brief filed by taxpayer. 9/9/41 copy served on General Counsel.

Dec. 17—Memorandum findings of fact and opinion rendered. Arnold, #12. Decision will be entered for the respondent. 12/18/41 copy served.

Dec. 18—Decision entered. Arnold, Div. 12.

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Mar. 17—Supersedeas bond in the amount of $14,000.00 approved and ordered filed.

Mar. 17—Petition for review by U. S. Circuit Court of Appeals, 8th Circuit, with assignments of error filed by taxpayer.

Mar. 18—Proof of service filed by taxpayer.

May 9—Motion for extension of 60 days from 5/16/42 to prepare and transmit the record filed by taxpayer.

May 9—Order enlarging time to July 15, 1942, to prepare and deliver the record entered.

June 17—Statement of evidence lodged.

June 17—Motion for hearing July 1, 1942, on statement of evidence filed by taxpayer, with proof of service of motion and statement of evidence thereon.

July 1—Hearing had before Mr. Murdock on approval of
3 statement of evidence Agreed statement filed at hearing. Referred to Mr. Arnold for approval.

July 1—Agreed statement of evidence approved and ordered filed.

July 8—Praecipe for record filed by taxpayer, with proof of service thereon.

Before United States Board of Tax Appeals

[File endorsement omitted.]

[Title omitted.]

*Petition*

Filed Aug. 1, 1940

Except as indicated below, the Petition filed August 1st, 1940 was identical in form and context with the "Amended Petition" hereinafter set out and which Amended Petition was lodged with the United States Board of Tax Appeals April 30, 1941. The exceptions are that Paragraph 3½; Paragraph 4-a½, and Paragraph 4½ of the Amended Petition (hereinafter set out) were not contained in the petition filed August 1, 1940; and that the prayer, signature and verification of the petition filed August 1, 1940, were not the same but in the original Petition were as follows:

"5. Wherefore, the petitioner prays that this Board may hear the proceedings and set aside the deficiency asserted by the Commissioner.

ELLSWORTH L. FULK,
*Agent for Petitioner,*
*1223 Sharp Building, Lincoln, Nebraska.*"

[*Duly sworn to by F. E. Roth; jurat omitted in printing.*]

4 [File endorsement omitted.]

[Title omitted.]

Before United States Board of Tax Appeals

*Answer*

Filed Sept. 3, 1940

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petitioner filed August 1, 1940 in the above-entitled proceeding admits and denies as follows:

1. Admits the allegations contained in paragraph 1, of the petition.

2. Admits that the taxes in controversy are income and excess-profits taxes in the amounts of $4,731.69 and $1,931.73, respectively, for the taxable year ended June 30, 1936. Denies the remaining allegations contained in paragraph 2 of the petition.

3. Denies that the Commission erred as alleged in paragraph 3 of the petition.

4 (a) and (b). Denies the allegations of facts contained in sub-paragraphs (a) and (b) of paragraph 4 of the petition.

Denies generally and specifically each and every allegation set forth in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the appeal be denied.

J. P. WENCHEL,
*Chief Counsel,*
*Bureau of Internal Revenue.*

of Counsel:
R. P. HERTZOG,
*Division Counsel.*
R. H. TRANSUE,
*Special Attorney,*
*Bureau of Internal Revenue.*

[File endorsement omitted.]
[Title omitted.]

Before United States Board of Tax Appeals

*Amended petition*

(*Lodged Apr. 30, 1941*)

The above-named petitioner hereby petitions for a determination of its income and excess-profits tax liability for the year ended June 30, 1936, and as a basis for such determination alleges as follows:

1. The petitioner is a corporation, incorporated in the State of Nebraska, with its principal office at 6th and South Streets, Lincoln, Nebraska. The petitioner's tax return for the year ended June 30, 1936, was filed with the Collector of Internal Revenue, Omaha, Nebraska, and disclosed no tax liability.

2. The Commissioner of Internal Revenue has deter-
6 mined the taxpayer's liability for income and excess-profits taxes for the year ended June 30, 1936, to be $14,951.85. The taxpayer has paid $8,288.43 of such tax, leaving a deficiency of $6,663.42. A copy of the Commissioner's notice of deficiency is attached hereto and marked Exhibit A. The taxpayer alleges that there is no deficiency but that it is entitled to a refund of $8,288.43. The net income and the tax liability of the taxpayer.

as determined by the Commissioner and as admitted by the taxpayer, are shown on exhibit B attached.

3. In determining the deficiency of $6,663.42, the Commissioner has erroneously reduced the petitioner's inventories at June 30, 1935, in the aggregate amount of $238,277.63, which amount was added to the petitioner's income for the year ended June 30, 1936, but was not deducted from the petitioner's income in determining its tax liability for the year ended June 30, 1935.

3½. The Commissioner used an inventory July 1, 1935, of $123,424.25 in computing petitioner's taxable net income for the year ended June 30, 1936. If the same inventory is used June 30, 1935, in computing the taxable net income for the year ended June 30, 1935, and no other adjustments are made, there would be a net loss for the year and an overassessment of $11,038.73.

4. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) After the death of the taxpayer's president on June 11, 1938, it was revealed that the taxpayer's inventories at June 30, 1935, which [fol. 13] were used as a credit to the cost of goods sold in determining the petitioner's taxable income for the year ended June 30, 1935, and as a charge to the cost of goods sold in determining the petitioner's taxable income for the year ended June 30, 1936, were very likely overstated. The extent of such overstatement cannot be determined as the inventory quantities are not available. However, the Commissioner has estimated the over statement to be as follows:

| | |
|---|---|
| Wheat | $203,078.54 |
| Flour | 25,828.71 |
| Accrued profit on wheat options | 1,173.30 |
| | 230,080.55 |

7 The petitioner contends that the above adjustments made by the Commissioner are incorrect because they are based on estimated inventory quantities which are incorrect. The petitioner also contends that the commissioner cannot use an opening inventory as at July 1, 1935, which is different from the closing inventory as at June 30, 1935.

(a½) Petitioner has paid $11,038.73 tax for the year ended June 30, 1935, based upon a taxable net income of $72,206.57. The closing inventory June 30, 1935, used in computing the gross profits which resulted in a taxable net income of $72,206.57 was $361,701.88. The Commissioner used an inventory of $123,424.58 as of July 1, 1935, in computing the taxable net income of $93,828.83 for the year ended June 30, 1936, which resulted in the proposed deficiency of $6,663.42. Had the Commissioner used the $123,424.58 as the closing inventory June 30, 1935,

instead of the inventory of $361,701.88, there would have been a net loss for the year ended June 30, 1935, of $166,070.73 and an overassessment of $11,038.73, the entire amount of the tax paid.

(b) The flour inventory as at June 30, 1935, which was used as a credit to the cost of goods sold in determining the petitioner's taxable income for the year ended June 30, 1935, and as a charge to the cost of goods sold in determining the petitioner's taxable income for the year ended June 30, 1936, was reduced in the amount of $8,197.08, which represents the processing tax which was imposed but not paid. The petitioner admits that the tax was not paid, but it contends that the Commissioner cannot use an opening inventory as at July 1, 1935, which is different from the closing inventory at June 30, 1935.

The petitioner's inventories at June 30, 1935, as used in its tax return for the year ended June 30, 1935, and as used by the Commissioner in determining the petitioner's taxable income for the year ended June 30, 1936, are shown below:

8 INVENTORIES 6-30-35 USED BY COMMISSIONER

| | Closing inventories year ended 6-30-35 | Reductions | Opening inventories year ended 6-30-36 |
|---|---|---|---|
| Wheat | $270,945.57 | $203,078.54 | $67,867.03 |
| Flour | 61,683.62 | 34,025.79 | 27,657.83 |
| Corn | 1,975.98 | | 1,975.98 |
| Package goods | 7,285.85 | | 7,285.85 |
| Sacks and twine | 11,451.98 | | 11,451.98 |
| Accrued profit on wheat options | 1,173.30 | 1,173.30 | |
| Accrued profit on flour contracts | 7,185.58 | | 7,185.58 |
| Total | 361,701.88 | 238,277.63 | 123,424.25 |

4½. Wherefore the Petitioner prays that this appeal may be considered and the deficiency claimed by Respondent set aside.

5. The petitioner further prays that it may have alternative relief as follows: If the Board finds that the opening inventory used by the Commissioner for 1936 is correct, then, and in that event, the Board shall apply the same to the year ending June 30, 1935, as closing inventory, showing that petitioner has been subjected to an overassessment for that year; and further, that the Board direct that said overassessment be applied by the Respondent as an offset, or recoupment, against any deficiency found for the year ending June 30, 1936.

(S) F. W. McREYNOLDS,
(S) ELLSWORTH L. FULK,
*Attorney and agent for Petitioner,*
*719-15 St. NW, Washington, D. C.*

[*Duly sworn to by J. M. Hammond; jurat omitted in printing.*]

9 *Exhibit A (1) to amended petition*

TREASURY DEPARTMENT,
INTERNAL REVENUE SERVICE,
*Omaha, Nebraska, May 7, 1940.*

OMAHA DIVISION
*676 Saunders-Kennedy Bldg.,*
GOOCH MILLING & ELEVATOR COMPANY,
*Sixth & South Streets, Lincoln, Nebraska.*

SIRS: You are advised that the determination of your income tax liability for the taxable year June 30, 1936, discloses a deficiency of $4,731.69 and that the determination of your excess-profits tax liability for the year(s) mentioned discloses a deficiency of $1,931.73, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Omaha, Nebraska, for the attention of LLN:90D. The signing and filing of this form will expedite the close of your return(s) by permitting an early assessment of the deficiencies, and will prevent the accumulation of inter-
10 est, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, GUY T. HELVERING,
*Commissioner,*
By (Signed) T. P. SMITH,
*Internal Revenue Agent in Charge.*

Enclosures:
Statement.
Form of waiver.

*Exhibit A (2) to amended petition*

STATEMENT

GOOCH MILLING & ELEVATOR COMPANY, SIXTH & SOUTH STREETS LINCOLN, NEBRASKA.

Tax Liability for the Taxable Year Ended June 30, 1936

| | Liability | Assessed | Deficiency |
|---|---|---|---|
| Income tax | $12,901.46 | $8,169.77 | $4,731.69 |
| Excess-profits | 2,050.39 | 118.66 | 1,931.73 |

In making this determination of your income and excess-profits tax liability, careful consideration has been given to the internal revenue agents reports dated September 10, 1937, November 1, 1937, July 19, 1938, and June 3, 1939, to your protest dated September 25, 1937, and to the statements made at the conference held at the Lincoln, Nebraska, office of the Internal Revenue Agent in Charge, Omaha, Nebraska, on October 8, 1937.

ADJUSTMENTS TO NET INCOME

| | | | |
|---|---|---|---|
| | Net loss as disclosed by return | | |
| | Unallowable deductions and additional income | | $ 5,533.47 |
| | (a) Advertising, disallowed | $ 2,708.91 | |
| | (b) Taxes, disallowed | 259.72 | |
| | (c) Processing tax accrual, disallowed | 124,127.59 | |
| | (d) Processing tax on sacks | 820.73 | |
| | (e) Contributions, disallowed | 766.98 | |
| | (f) Inventory adjustment, June 30, 1935 | 237,104.33 | |
| | | | 365,788.26 |
| | Total | | 360,254.79 |
| 11 | Nontaxable income and additional deductions: | | |
| | (g) Attorney's fees allowed | 10,000.00 | |
| | (h) Inventory adjustment, June 30, 1936 | 216,098.33 | |
| | (i) Processing Tax on flour in transit, 1/6/36 | 3,218.54 | |
| | (j) Processing tax withheld by court, allowed | 1,639.60 | |
| | (k) Commodity loss allowed | 34,508.87 | |
| | (l) Bonus allowed | 200.00 | |
| | (m) Refund of processing tax on sacks | 563.05 | |
| | (n) Liquidating dividend eliminated | 134.40 | |
| | (o) Miscellaneous income adjustment | .17 | |
| | | | 266,425.96 |
| | Net Income Adjusted | | $93,828.83 |

*Exhibit B to amended petition*

| | As shown by Commissioner's report | Admitted by taxpayer | Difference |
|---|---|---|---|
| Net income | $93,828.83 | $144,448.80 | $238,277.63 |
| Income subject to excess profits tax: | | | |
| Declared value | 400,000.00 | 400,000.00 | |
| Net income for year ended June 30, 1935 | 22,568.35 | 22,568.35 | |
| Adjusted value | 422,568.35 | 422,568.35 | |
| 12½% of adjusted value | 52,821.04 | 52,821.04 | |
| Income subject to tax | 41,007.79 | | 41,007.79 |
| Income tax at 13¾% | 12,901.46 | | 12,901.46 |
| Excess-profits tax at 5% | 2,050.39 | | 2,050.39 |
| | 14,951.85 | | 14,951.85 |
| Previously paid | 8,288.43 | 8,288.43 | |
| Deficiency | 6,663.42 | 8,288.43 | 14,951.85 |

12 [File endorsement omitted.]

Before United States Board of Tax Appeals

[Title omitted.]

*Motion for leave to file amended petition.*

Filed April 30, 1941

Comes now Petitioner, by it's attorney, F. W. McReynolds, and moves this Honorable Board for leave to file an amended Appeal Petition, hereto attached.

The grounds for this motion are that, since the original petition was filed, certain court and other decisions have been rendered which make it necessary to include additional facts therein, and to ask for alternative relief.

Respectfully submitted,

GOOCH MILLING & ELEVATOR COMPANY,
*Petitioner.*

By F. W. MCREYNOLDS,
*Attorney.*

[Title endorsement omitted.]

Before United States Board of Tax Appeals

GOOCH MILLING AND ELEVATOR COMPANY, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 103993

J. Lee Rankin, *Esq.*, for the petitioner.
Angus R. Shannon, Jr., *Esq.*, for the respondent.

*Memorandum findings of fact and opinion*

Dec. 17, 1941

ARNOLD: This proceeding involves an income tax de-
13 ficiency of $4,731.69 and an excess-profits tax deficiency of $1,931.73 for the fiscal year ended June 30, 1936. Petitioner alleges that respondent

erroneously reduced the petitioner's inventories at June 30, 1935 in the aggregate amount of $238,277.63, which amount was added to the petitioner's income for the year ended June 30, 1936, but was not deducted from the petitioner's income in determining its tax liability for the year ended June 30, 1935.

Petitioner alleges that it is entitled to a refund of $8,288.43.

On April 30, 1941 petitioner filed a motion with the Board requesting leave to file an amended petition and to seek alternative relief. The amended petition was "lodged" with the Board and by consent of counsel the motion for leave to amend was taken under advisement pending consideration of the case on its merits. Respondent objected to the filing of the amended petition upon the ground that the Board is without jurisdiction to consider the matters therein contained, which relate to petitioner's tax liability for the fiscal year 1935, a year not before the Board.

*Findings of fact*

Petitioner is a Nebraska corporation with its principal office in Omaha. Its income tax returns were filed with the collector of internal revenue at Omaha, Nebraska.

On its income tax return for the fiscal year 1936 petitioner reported a net loss of $5,533.47. As a result of various adjustments respondent determined that petitioner's net income for 1936 was $93,828.83, upon which he computed a tax liability of

$14,951.85 of which $8,288.43 has been paid leaving the deficiencies hereinabove set forth.

The principal adjustment that respondent made related to petitioner's inventories. Petitioner's balance sheet for the taxable year shows an opening inventory of $361,701.88, and a closing inventory of $345,017.43. The deficiency letter shows that respondent reduced petitioner's opening inventory at July 1, 1935 by the following adjustment, "inventory adjustment, June 30, 1935, $237,104.33." The deficiency herein results primarily from this adjustment of petitioner's inventory.

Following the death of petitioner's president on June 11, 1938, an audit of petitioner's books revealed that all inventories
14 as far back as 1928 were erroneous. The reduced inventory was first computed by petitioner's accountants and was accepted by respondent as the basis for the present deficiencies.

Based upon corrected inventories the petitioner had overpaid its income taxes for all the years 1928 to 1934, inclusive, in a net sum in excess of $8,000. The revenue agent's report for the fiscal year 1935 shows an over-assessment for the fiscal year 1935 in the sum of $7,935.58, which amount is not subject to refund because barred by the statute of limitations.

*Opinion*

Petitioner, as we understand its position, does not deny its liability for the deficiencies asserted. It contends that it is entitled to use the defense of recoupment, i. e., as against the deficiency asserted, is entitled to set over and have credited against the same its over-payment of taxes in the fiscal year 1935. It cites and relies upon Bull v. United States, 295 U. S. 247, Stone v. White, 301 U. S. 532, Crossett Lumber Co. v. United States, 87 Fed. (2d) 930, Dixie Margarine Co. v. Commissioner, 115 Fed. (2d) 445, and Mills v. United States, 35 Fed. Supp. 738.

Despite petitioner's impressive argument on the equities in its behalf we are unable, for jurisdictional reasons, to grant the relief which petitioner desires. None of the above court cases hold that the Board has jurisdiction to consider the doctrine of equitable recoupment with respect to statutory deficiencies. The Board itself has held that it has no authority under the limited jurisdiction conferred upon it to apply the principles of recoupment. Red Wing Potteries, Inc., 43 B. T. A. 841, Helmuth Heyl, 34 B. T. A. 223; see also Lyeth v. Hoey, 112 Fed. (2d) 4, United States ex rel. Girard Trust Co. v. Helvering, 301 U. S. 540. Under our decisions we have no jurisdiction to consider the defense raised by this petitioner. The motion for leave to amend the petition is therefore denied.

Decision will be entered for the respondent.
[Entered: December 17, 1941.]
(Seal) Board of Tax Appeals, 1924.

15 [File endorsement omitted.]

Before United States Board of Tax Appeals

GOOCH MILLING AND ELEVATOR COMPANY, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 103993

*Decision*

(Entered Dec. 18, 1941)

Pursuant to the determination of the Board, as set forth in its Memorandum Findings of fact and opinion entered December 17, 1941, it is ordered and decided: That there are deficiencies in income and excess-profits taxes for the fiscal year ended June 30, 1936, in the respective amounts of $4,731.69 and $1,931.73.

(S) WILLIAM ARNOLD.

Entered Dec. 18, 1941.
(Seal) Board of Tax Appeals, 1924.

Before United States Board of Tax Appeals

[Title omitted.]

*Petition for Review and Assignment of Errors*

Filed March 17, 1942

To the Honorable, the Judges of the United States Circuit Court of Appeals for the Eighth Circuit:

16 The Gooch Milling & Elevator Company, petitioner, respectfully petitions this Honorable Court of review the decision of the United States Board of Tax Appeals entered December 17, 1941, finding a deficiency in income and excess profit taxes of $6,663.42 due from petitioner for the fiscal year ending June 30, 1936.

JURISDICTION

Your petitioner is a corporation duly organized and existing under the laws of the State of Nebraska with its principal place of business at Lincoln, Nebraska. It filed its income tax returns for the fiscal years ending June 30, 1935, and June 30, 1936, with

the Collector of Internal Revenue for the State of Nebraska, at Omaha, Nebraska, located within the Jurisdiction of the Circuit Court of Appeals for the Eighth Judicial Circuit. The jurisdiction of the Court to review the decision of Board of Tax Appeals aforesaid is given by Sections 1140 to 1146 inclusive of the Internal Revenue Code of 1939.

NATURE OF CONTROVERSY

Petitioner's income tax return for the year ending June 30, 1935, was based upon a greatly inflated inventory as of that date, and the same inflated inventory was used as the opening inventory for the year beginning July 1, 1935, and ending June 30, 1936. These errors were not discovered until 1938 when its president and manager committed suicide. Immediate audits were then made of petitioner's books and records by both Internal Revenue and private auditors, who agreed as to results. These audits disclosed that back as far as 1928 income tax returns had been based on erroneous inventories, and during this period petitioner had overpaid its income taxes by more than $8,000. In 1935 the closing inventory of June 30, and the opening inventory of July 1, had been inflated in the sum of $237,104.33. Correction of this error resulted in showing that petitioner had overpaid its taxes for year ending June 30, 1935, by the sum of $7,935.58, and under-paid its taxes for the year ending June 30, 1936, by the sum of $6,663.42. On May 7, 1940, the Commissioner made formal demand for this deficiency.

17 On August 2, 1940, petitioner appealed to the Board of Tax Appeals from this demand, on the ground that different inventories could not be used for the ending of 1935 and beginning of 1936 tax years. On April 30, 1941, petitioner filed with the Board an amended petition in which it asked, if the 1936 deficiency were approved, that it be allowed equitable recoupment against the same, pro tanto, of the overpaid taxes for 1935. The Commissioner objected to this amended petition on the ground that the Board had not power to grant the relief sought. The Board withheld decision of the objection until the case was heard on the merits. At the trial proof was given of the facts as to the June 30–July 1, 1935 inventories, and the overpayment of income taxes for 1935 and prior years, and equitable recoupment again set up as a defense against the 1936 deficiency.

On December 17, 1941, the Board of Tax Appeals handed down its finding of facts and opinion. It held that it had "no jurisdiction to consider the defense raised" and refused to allow the appeal petition to be amended as hereinbefore set forth.

*Assignment of errors*

The United States Board of Tax Appeals erred as follows:

1. In refusing to allow the appeal petition to be amended as prayed.

2. In holding that it had no jurisdiction of the defense of equitable recoupment in this case.

3. In denying petitioner the relief of equitable recoupment, pro tanto, of the 1935 income tax overpayment against the deficiency demanded for 1936.

Wherefore petitioner prays that this Honorable Court may review the decision of the United States Board of Tax Appeals and reverse and set aside the same and direct said Board to allow the defense of equitable recoupment of the 1935 tax overpayment, pro tanto, against the tax deficiency for 1936; and for such further orders and directions as shall by this Court be deemed meet and proper, in accordance with law.

(S) F. W. McREYNOLDS,
F. W. McReynolds,
*Union Trust Building, Washington, D. C.,*
*Attorney for Petitioner.*

18 [*Duly sworn to by F. W. McReynolds; jurat omitted in printing.*]

To: COMMISSIONER OF INTERNAL REVENUE, *Washington, D. C.:*

You are hereby notified that on the 13th day of March, 1942, a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit, of the decision of the United States Board of Tax Appeals heretofore rendered in the above entitled cause, was filed with the Clerk of said Board. A copy of the petition as filed is attached hereto and served upon you.

Dated: March 13, 1942.

(S) F. W. McREYNOLDS,
F. W. McReynolds,
*Union Trust Building, Washington, D. C.*

Service of the foregoing notice of filing and copy of the petition for review is hereby, acknowledged this 18th day of March, 1942.

(S) J. P. WENCHEL,
*Chief Counsel,*
*Bureau of Internal Revenue,*
*Attorney for Respondent.*

United States Board of Tax Appeals, March 18, 1942.

19 Before United States Board of Tax Appeals

[File endorsement omitted.]

[Title omitted.]

*Statement of evidence*

(Filed at Hearing July 1, 1942)

The above-entitled cause came on for hearing at Omaha, Nebraska, before the Honorable William W. Arnold, Member of the United States Board of Tax Appeals, on the 26th day of May, 1941, petitioner being represented by J. Leo Rankin, Esq., and respondent by Angus R. Shannon, Jr. Esq., whereupon the following proceedings were had.

Petitioner's Amended Petition was considered and Respondent objected to it being filed. The Member ruled as follows:

"I will not pass on the right of the petitioner to file this amended petition at this time, but will admit the evidence to be submitted and then that matter can be thrashed out as to the right to file the amended petition, in the brief."

Whereupon Ellsworth L. Fulk, a witness called on behalf of petitioner, testified on direct examination as follows:

I am a certified public accountant and have audited the accounts and records of petitioner since 1933. I prepared it's income tax returns for years ending June 30, 1935 and 1936. Both returns show in full the inventories upon which they are based.

Whereupon petitioner's income and excess-profits tax returns for 1936 and 1935 were received in evidence as Petitioner's Exhibits 1 and 2, respectively.

Thereupon, there were received in evidence as Petitioner's Exhibit 3 copies of four reports of the Revenue Agent
20 on the examination of petitioner's income and excess-profits tax return for the year ended June 30, 1936.

There were three examinations and all three examinations are included in Exhibit 3. The last report, dated June 3, 1939, upon which the deficiency notice is based, differs from the others.

Thereupon petitioner's counsel stated that he was offering in evidence Revenue Agent's report dated June 3, 1939, on the examination of the petitioner's income and excess-profits tax return for the year ended June 30, 1935, for the sole purpose of showing the computation of the overassessment with regard to petitioner's tax for the year 1935, computed upon the basis of the reappraisal of the inventories of the petitioner for that period. Said report was received in evidence as Petitioner's Exhibit 4.

Said Exhibit 4 shows an overassessment of income tax for the year ending June 30, 1935 of $7,935.58. In preparing the return for 1935, I did not check the inventories as to quantities but only as to prices and extensions.

Something occurred in 1938 to cause a recheck of the petitioner's inventory over a period of time. On June 11, 1938, Mr. Gooch, president of petitioner, killed himself. An examination then made showed discrepancies in the inventories, and they were then worked back from an actual inventory made at that time. We started with the inventory taken in June 1938, and computed the inventories back each year to, I believe, 1929. The inventory adjustment made by the Treasury Department as of June 30, 1935, decreased the income for the year ended on that date and increased the income for the year ending June 30, 1936. The amount of the inventory adjustment was $238,000, if my memory is correct. If this adjustment had been applied to 1935, there would have been no income or no tax for that year.

Thereupon, two checks were received in evidence as Petitioner's Exhibits 5 and 6. Exhibit 5 is a check for $1,124.87, which paid the tax shown by the return filed for the year ended June 30, 1935. Exhibit 6 is a check for $10,854.98, which is a check for additional tax for the year 1935, plus interest. I computed the interest, and advised the petitioner to pay the tax.

Without this change in inventory, there would have been no tax due for 1936; with it, the deficiency claimed by respondent is due. Without this inventory change, there
21 would have been no taxable income for 1936. This change causes us to have less income for 1935 than we originally had, based on book inventories, and an overassessment for that year. If petitioner's amended petition is allowed, the same inventory will be used for the closing inventory for 1935 as is used by respondent as opening inventory for 1936 and this will make an overassessment for 1935. For the two years there would be a balance due petitioner of about $3,400.

Cross-examination of said ELLSWORTH L. FULK:

Sometime in 1939, we computed the inventory of the petitioner as of July 1, 1935, to be $123,434.45. There was an audit of petitioner's books made in June 1938 by Arthur Andersen & Company of Chicago. We didn't agree with it. We do not disagree with the audit in June 1938, but, as I recall, they worked back the inventories for 1 or 2 years, and then, when we came into the matter from the tax angle we worked them back and we did not

come out with the same inventory, but we never tried to reconcile it. I don't know what the difference was. The difference would probably be in computing the inventory through moisture. In other words, we take the actual inventory, and have the dry wheat and dirty wheat purchased, then our wheat ground is weighed after it is cleaned and the moisture added. So, to work the inventory back, we had to take the inventory of June 30, 1938, and take the wheat purchased and the wheat ground and work it back. We probably used a different moisture content.

I am familiar with the figure the respondent has used in his deficiency notice with regard to inventories. I do not disagree with that figure. It is the figure that we computed.

We computed the inventories and taxes back to 1928. In 1928 there was an overassessment of $5,736.76; in 1929, additional tax due of $10,744.07; in 1930, an overassessment of $6,011.40; in 1931, an overassessment of $4,160.24; in 1932, an overassessment of $2,260.95; in 1933, no tax paid, no tax due; in 1934, additional tax of $384.72. These were my original computations. The overassessment of $7,935.58 shown in Petitioner's Exhibit 4 is the difference between the amount of tax paid and the amount of the tax computed by the revenue agent on his last examination
22 of the books for the year ended June 30, 1935. This resulted from inventory adjustments and adjustment of processing tax on sacks.

Redirect examination of Mr. FULK:

Revision of inventories back to 1938, omitting 1935 and 1936, would result in a refund to petitioner of $6,970.14. Referring to Petitioner's Exhibit 4, in processing tax on sacks there is an item $563.05 one way and $1,112.00 the other way. The balance of the adjustments are the inventory matters I have been discussing.

Whereupon Mr. H. R. Ponder, being called as a witness for petitioner, testified on direct examination as follows:

I am a certified public accountant employed by Ellsworth L. Fulk. Under his employment I reaudited the inventories of petitioner in 1939, for years prior to 1938. There were no actual inventories available. We took the inventory at June 18, 1938, and added thereto the purchases made since the previous year end, June 30, 1937, and deducted therefrom the bushels of wheat ground and arrived at the bushels of wheat that should have been in the inventory at June 30, 1937; and for each year back to 1928 we used the same procedure to determine the bushels of wheat in the inventory at June 30. Due to the fact that the

wheat was purchased on the basis of dry, unclean wheat, whereas our records of the grind were on the basis of clean, moist wheat, it was necessary to make an adjustment for the gain in moisture. This was done from the records of the Lincoln Grain Exchange, which tests all wheat purchased by the company. Petitioner's own records showed moisture of wheat ground. The difference between these average moistures of wheat purchased and wheat ground we considered as a gain in milling, and eliminated that from the computation in order to arrive at the correct inventory at the end of each year. This was the best method I could devise. There was a reason for stopping with the check-back at the year 1928. At June 30, 1928, the books of the company showed the number of bushels of wheat on hand, as well as the value of the wheat on hand. It appeared from the records at that point that the inventory was probably correct prior to that period. It appeared that the amount of the inventory was correct, based on the current price of wheat at that time; and, also, our computations which we had made indicated that the inventory
23 shown by the books was very close to the computation which we had made. I believe there was a difference of about 14,000 bushels.

The agent in charge took the inventory figure that is shown in the letter fixing the deficiency for the year 1936 from the figures which I had computed, in the manner that I have described. It is my opinion that that is as accurate an approximation of the inventory of the company, as of July 1, 1935, as can be obtained. It is my opinion that the correct inventory of the company as of June 30, 1935, should be $123,424.25, and that of July 1, 1935, was the same.

No cross-examination.

The foregoing is all of the evidence adduced at the hearing before the United States Board of Tax Appeals material to this proceeding, and is hereby agreed to by the undersigned.

F. W. McREYNOLDS,
*Attorney for Petitioner on Review.*
J. P. WENCHEL,
*Chief Counsel,*
*Bureau of Internal Revenue,*
*Attorney for the Respondent on Review.*

Approved July 1, 1942.

(S) WILLIAM ARNOLD, *Member.*

Before United States Board of Tax Appeals

[File endorsement omitted.]

[Title omitted.]

*Praecipe for record*

Filed July 8, 1942

To the Clerk of United States Board of Tax Appeals:

24 You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, copies duly certified as correct of the following documents and records in the above mentioned cause in connection with the petition for review by said Circuit Court of Appeals for the Eighth Circuit heretofore filed by Petitioner on review:

1. Docket entries of the proceedings before the Board.
2. Pleadings before the Board: (a) Petition with annexed copy of deficiency letter; (b) Amended Petition with Motion for leave to file; (c) Answer to original petition.
3. Statement of evidence.
4. Memorandum of Findings of fact and opinion by the Board.
5. Decision of the Board of December 18, 1941.
6. Petition for review with proof of service of notice of filing same and of a copy of said petition.
7. Order enlarging time for preparation of evidence and for transmission and delivery of the record.
8. This praecipe.

F. W. McREYNOLDS,
*Attorney for Petitioner on Review.*

Service of a copy of the above praecipe is hereby admitted this 23rd day of June 1942.

J. P. WENCHEL,
*Chief Counsel, Bureau of Internal Revenue.*

25 [Clerk's certificate to foregoing transcript omitted in printing.]

*Order of submission*

November Term, 1942—Tuesday, November 10, 1942

This cause having been called for hearing in its regular order, argument was commenced by Mr. D. M. Kelleher, for petitioner, continued by Mr. Arthur A. Armstrong, Special Assistant to Attorney General, for respondent, and concluded by Mr. D. M. Kelleher for petitioner.

Thereupon, this cause was submitted to the Court on the transcript of the record from said Board of Tax Appeals and the briefs of counsel filed herein.

United States Circuit Court of Appeals, Eighth Circuit

No. 12372—January Term, A. D., 1943

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GOOCH MILLING & ELEVATOR COMPANY, PETITIONER

*vs.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition to Review Decision of the United States Board of Tax Appeals

January 29, 1943

Mr. D. M. Kelleher (Mr. F. W. McReynolds was on the brief) for Petitioner.

Mr. Arthur A. Armstrong, Special Assistant to the Attorney General (Mr. Samuel O. Clark, Jr., Assistant Attorney General, and Mr. Sewall Key, Mr. J. Louis Monarch, and Mr. Newton K. Fox, Special Assistants to the Attorney General, were on the brief) for Respondent.

Before GARDNER, WOODROUGH, and THOMAS, Circuit Judges.

GARDNER, Circuit Judge, delivered the opinion of the court.

This case is before us on petition to review a decision of the Board of Tax Appeals determining a deficiency in income and excess profit taxes of petitioner for the fiscal year ended June 30, 1936, in the respective amounts of $4,731.69 and $1,931.73.

Petitioner is a Nebraska Corporation operating flour mills. Following the death of its president on June 11, 1938, an audit

of the books showed that all inventories as far back as 1928 had been overstated. The reduced inventory for the fiscal year 1936 was first computed by petitioner's accountants and later accepted by the Commissioner as the basis for determining tax deficiencies. Petitioner's income tax return for the fiscal year 1936 reported a net loss, but the Commissioner reduced the opening inventory of July 1, 1935, that being the beginning of petitioner's fiscal year, by $237,104.33, and the deficiency resulted primarily from that adjustment. Based on these corrected inventories the petitioner had overpaid its income taxes for all the fiscal years 1928 to 1934 inclusive in excess of $8,000.00. A revenue agent's report for the fiscal year 1935 showed an overassessment of $7,935.58. The Commissioner, based, on this report, determined a deficiency of $4,731.69 in income taxes, and a deficiency of $1,931.73 on account of excess profit taxes for the fiscal year ended June 30, 1936. The taxpayer then filed its petition with the United States Board of Tax Appeals for a redetermination of the deficiencies. In its original petition to the Board the taxpayer alleged that the Commisisoner had determined its liability for income and excess profits for the year ended June 30, 1936, to be $14,951.85; that it had paid $8,288.43 of such tax, leaving a balance of $6,663.42; that there was in fact no deficiency, but that it was entitled to a refund of $8,288.43; that in determining the deficiency of $6,663.42 the Commissioner had erroneously reduced petitioner's inventories at June 30, 1935, in the aggregate amount of $237,104.33, which amount was added to petitioner's income for the year ended June 30, 1936, but was not deducted from its income in determining its tax liability for the year ended June 30, 1935. Thereafter the taxpayer filed a motion with the Board requesting leave to file an amended petition which contained allegations that the Commissioner used an inventory of $123,424.25 on July 1, 1935, in computing its taxable net income for the year ended June 30, 1936; that if the same inventory were used June 30, 1935, in computing the taxable net income for the year ended June 30, 1935, and no other adjustments were made there would be a net loss for the year and an overassessment of $11,038.73.

The amended petition sought alternative relief and asked to have the overassessment for the fiscal year 1935 applied as an offset or recoupment against the deficiencies found for the fiscal year 1936. The motion for leave to amend was taken under advisement pending consideration of the case on its merits. The Board entered findings of fact as follows:

"Petitioner is a Nebraska corporation with its principal office in Omaha. Its income tax returns were filed with the collector of internal revenue at Omaha, Nebraska.

"On its income tax return for the fiscal year 1936 petitioner reported a net loss of $5,533.47. As a result of various adjustments respondent determined that petitioner's net income for 1936 was $93,828.83, upon which he computed a tax liability of $14,951.85 of which $8,288.43 has been paid leaving the deficiencies hereinabove set forth.

"The principal adjustment that respondent made related to petitioner's inventories. Petitioner's balance sheet for the taxable year shows an opening inventory of $361,701.88, and a closing inventory of $345,017.43. The deficiency letter shows that respondent reduced petitioner's opening inventory at July 1, 1935, by the following adjustment, 'inventory adjustment, June 30, 1935, $237,104.33.' *The deficiency herein results primarily from this adjustment of petitioner's inventory.*

"Following the death of petitioner's president on June 11, 1938, an audit of petitioner's books revealed that all inventories as far back as 1928 were erroneous. The reduced inventory was first computed by petitioner's accountants and was accepted by respondent as the basis for the present deficiencies.

"Based upon corrected inventories the petitioner had overpaid its income taxes for all the years 1928 to 1934, inclusive, in a net sum in excess of $8,000. The revenue agent's report for the fiscal year 1935 shows an overassessment for the fiscal year 1935 in the sum of $7,935.58, which amount is not subject to refund because barred by the statute of limitations." [Italics supplied.]

The Board held that it was unable "for jurisdictional reasons to grant the relief which petitioner desires" and sustained the Commissioner's determination of deficiencies.

Petitioner seeks reversal on the grounds that the Board erred: (1) in refusing to allow the taxpayer to amend its petition; (2) in holding that it was without jurisdiction to apply the doctrine of equitable recoupment; (3) in denying the relief of equitable recoupment. While the Government in these proceedings has and is asserting a deficiency in the payment of income and excess profit taxes for the fiscal year 1936, it appears without dispute that it has collected and still holds in its hands money paid by the taxpayer in excess of the amount justly due for income and excess profit taxes for the fiscal year 1935. This money, though collected by mistake, is wrongfully withheld by the Government. The overpayment was discovered in connection with an investigation of a claimed deficiency in income and excess profit taxes for the fiscal year 1936. The Commissioner determined upon a correction or adjustment of the inventory of June 30, 1935, and then used it as the beginning inventory of the 1936 tax year. This inventory was reduced by $237,104.33 so as to make it $123,424.25. The taxpayer paid some $8,288.43 of the deficiency

determined for 1936 but there remained unpaid $6,663.42, the amount here involved. As to this claimed deficiency the taxpayer insists that it was entitled, under the doctrine of equitable recoupment, to offset the overpayment which it had made on the 1935 taxes. The Board in its findings states that "the deficiency herein resulted primarily from this adjustment of petitioner's inventory." In other words, without such readjustment there would be no deficiency. The adjustment of the beginning inventory for the 1936 taxable year automatically changed the 1935 closing inventory and established the error in the basis for computing the 1935 tax. Having collected and retained the taxes on the basis of the uncorrected inventory it is urged that the Government should not, in determining the question of the amount due for the 1936 taxes, insist on this adjustment and that to do so is violative of fundamental principles of abstract justice. Bull v. U. S., 295 U. S. 247; Crossett Lumber Co. v. U. S., 8th Cir. 87 F. 2d 930. In the first cited case as in the case at bar, the statute of limitations had run against a claim for overpayment of taxes and the question was whether such claim might not be offset against the Government's claim for taxes due. Addressing itself to the inquiry as to what remedy the taxpayer under such circumstances might have, the Court among other things said: "In a proceeding for collection of estate tax the United States through a palpable mistake took more than it was entitled to. Retention of the money was against morality and conscience. But claim for refund or credit was not presented or action instituted for restitution within the period fixed by the statute of limitations. If nothing further had occurred, congressional action would have been the sole avenue of redress.

"In July 1925, the Government brought a new proceeding arising out of the same transaction involved in the earlier proceeding. This time, however, its claims was for income tax. The taxpayer opposed payment in full, by demanding recoupment of the amount mistakenly collected as estate tax and wrongfully retained. Had the Government instituted an action at law, the defense would have been good. The United States, we have held, cannot, as against the claim of an innocent party, hold his money which has gone into the treasury by means of the fraud of their agent. United States v. State Bank, 96 U. S. 30, 24 L. Ed. 647. While here the money was taken through mistake without any element of fraud, the unjust detention is immoral and amounts in law to a fraud on the taxpayer's rights. What was said in the State Bank Case applies with equal force to this situation. 'An action will lie wherever the defendant has received money which is the property of the plaintiff and which the defendant

is obliged by natural justice and equity to refund. The form of the indebtedness or the mode in which it was incurred is immaterial * * * * * * If the claim for income tax deficiency had been the subject of a suit, any counterdemand for recoupment of the overpayment of estate tax could have been asserted by way of defense and credit obtained, notwithstanding the statute of limitations had barred an independent suit against the Government therefor. This is because recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded. Such a defense is never barred by the statute of limitations so long as the main action itself is timely."

In Crosset Lumber Co. v. U. S., supra, speaking of the doctrine of recoupment, Judge Thomas speaking for this court among other things said: "The basis of the doctrine is that principle of natural justice which denounces a claim as unjust, immoral, and fraudulent when the claimant is at the same time wrongfully withholding money which in equity belongs to the other party. An action to recover taxes is in the nature of an action for money had and received. Although in form it is an action at law, it is governed by equitable principles (citing cases). In such an action a plaintiff cannot recover unless he can show that in equity and in good conscience he is entitled, as against the defendant, to the money. * * * In the case at bar one act, the erroneous valuation of the inventory of November 30, 1926, set in motion a course of events resulting in the erroneous refund to the taxpayer on one hand, and an overpayment in his favor on the other. Had the Government within the time limited brought an action to recover the refund made erroneously by the inventory, the taxpayer could have set up by way of defense its overpayment of income tax of the following year, induced by the same erroneous inventory. There is a direct connection in this case between income taxes paid in successive years based upon a single erroneous inventory as there was between the estate tax erroneously determined and income tax correctly determined on the same item in Bull v. United States, supra. That being the situation, it is immaterial that the parties are reversed and the taxpayer is bringing the suit."

In the instant case the taxpayer is asserting the right to recoup a claim for overpayment of taxes, but the principle applied in the Crossett Lumber Co. case is applicable here. Here, as in that case, there was a correction of an inventory. The inventory serves a double purpose. If fixes stock on hand at the end of one fiscal year and at the same time determines the same fact for the beginning of the ensuing year. The elimination of $237,-

104.33 from the inventory of June 30, 1935, automatically brought about a deficiency in the income tax for the fiscal year 1936. Whereas, if the taxpayer were permitted to use the original inventory there would be no deficiency for the fiscal year 1936. The same fact that establishes a deficiency for the fiscal year 1936 establishes an overpayment for the fiscal year 1935, and discloses that the Government has in its hands funds of the taxpayer which it would not have had were it not for the overstatement in the inventory. In this situation a manifest wrong results if the administrative tribunal or the court is powerless to prevent an unjust enrichment of one of the parties before it. Recoupment is purely defensive and is equitable in its nature. It reduces the claim affirmatively urged so far as in reason and conscience it ought. Stone v. White, 300 U. S. 530. Williams v. Neeley, 8th Cir. 134 F. 1. That the facts and circumstances here disclosed are such as to give rise to the right of recoupment is not seriously questioned. But it is urged that the Board of Tax Appeals is without authority to recognize this doctrine. The Board was created by the 1924 Congressional Act for "great remedial purposes." Helvering v. Taylor, 293 U. S. 507. The 1926 Act amended the 1924 Act by making provision for direct appeal from the Board to the Circuit Courts of Appeals, thus eliminating retrial in the District Court required under the 1924 Act. While the Board is not a court it has been called by the Board itself "a new creature with a special place in the Governmental system of settling disputes." Union Metal Mfg. Co., 4 B. T. A. 287. It has also been referred to as an "independent, Board of experts to decide impartially between the Government and the taxpayer." Avery v. Commissioner, 5th Cir., 22 F. 2d 6. The purpose of Congress in establishing the Board was to bestow at least quasi judicial functions, and to create for the trial of tax cases a body similar to the federal district court and the Court of Claims. Blair v. Osterlein Machine Company, 275 U. S. 220; Williamsport Wire Rope Co. v. U. S., 277 U. S. 551; Garden City Feeder Co. v. Commissioner, 75 F. 2d 804. The Board exercises functions similar to those exercised by a federal district trial court without a jury, Commissioner v. Liberty Bank and Trust Co., 6th Cir., 59 F. 2d 320. It has authority to redetermine deficiencies of income, estate and gift taxes asserted by the Commissioner. While it has no general equitable jurisdiction it has "the power to do full justice to the parties while they are still before it." Helvering v. Edison Securities Corp., 4th Cir., 78 F. 2d 85. In the last cited case the court among other things said: "Even after a full trial below an appellate court has the power to remand a case for further proceedings if it has

been tried on a wrong theory. Underwood v. Commissioner (CCA) 56 F. 2d 67 and 73; and it cannot be doubted in view of the purpose for which the Board was established and of the statutes governing its procedure, that it has equal power to do full justice to the parties while they are still before it." It has been held that an administrative tribunal is not deprived of the power to recognize the right of recoupment, because, as above noted, it has appellate powers, judicial in nature. Blair v. Osterlein Co., supra; Garden Feeder Co. v. Commissioner, supra; Bishoff v. Commissioner, 3rd Cir., 27 F. 2d 91; Cook v. U. S., 5th Cir., 198 F. 2d 804; Houston Street Corp. v. Commissioner, 5th Cir., 84 F. 2d 821.

In Blair v. Osterlein the Supreme Court, in speaking of the power of the Board, said "an examination of the sections creating the Board and investing it with power can leave no doubt that they were intended to confer upon it appellate powers which are judicial in character." On appeal from a decision of the Board of Tax Appeals this court may affirm, modify, or reverse the decision of the Board with or without remanding the case for rehearing, as justice may require. Hormel v. Helvering, 312 U. S. 552.

It is, however, the contention of respondent that the power to recognize the doctrine of recoupment as it is presented in this case is lacking because of statutory provisions, and Sec. 272 (g) of the Revenue Act of 1934 is relied upon. This provision reads as follows:

"The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid."

In Dixie Margarine Company v. Commissioner, 6th Cir., 115 F. 2d. 445, the Court upheld the power of the Board to allow a recoupment based on an overpayment of tax for a prior year, although right to sue to recover same was barred by the statute of limitations. In the course of the opinion it is said "in the present case the claim for refund and the deficiency assessment had a common origin, namely, the erroneous application of the Oleomargarine Act to petitioner's product, and petitioner's claim is therefore available in recoupment.

"The Board had no occasion to consider whether the statute of limitation affected the availability of petitioner's claim in recoupment. We think it did not." The Board having failed to permit recoupment, its decision was reversed and the case

remanded for further proceedings in accord with the views expressed by the Circuit Court of Appeals.

Respondent quotes that part of the above statute which contains the limitation on the power of the Board, but we think it important to observe that the statute specifically provides that the Board "in redetermining a deficiency in respect to any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency." It should be considered as a whole and, if possible, all its provisions given effect. Jones v. York County, 8th Cir., 47 F. 2d 837. Unlimited power is vested in the Board to investigate and consider the facts with relation to the taxes of other taxable years in determining deficiencies of any particular year. The limitation is to the effect that the Board shall not "determine" that the tax for any other taxable year has been overpaid or underpaid. Whatever facts with relation to the taxes of other taxable years may be necessary in order to determine the amount of the deficiency may be considered.

The existence of a deficiency for the year 1936 was determined here and could only be determined by considering the tax for 1935. The two years are so tied together, that the deficiency for 1936 depends upon the corrected inventory for June 30, 1935. That inventory, if adopted, automatically reduces the amount of taxes assessable for 1935, and its appears as an incident to this investigation of the taxes for 1936, that the amount collected for 1935 exceeded the resulting deficiency claimed for 1936. The single act of reducing the inventory gave rise to an overpayment for one year and a deficiency in the other. Why should the power be granted the Board to consider "facts with relation to the taxes for other taxable years" unless the results of that investigation may be applied by the Board in determining the amount of the deficiency that should be paid for the year under investigation? The Board did not have to determine the amount of the taxes for 1935, it only needed to consider the effect of the change in the inventory which normally should have been the same for each year. Its investigation disclosed the fact that the corrected inventory should not in justice be resorted to in redetermining the tax for either of the years 1935 or 1936. Under the circumstances disclosed the Board should prevent respondent from taking advantage of a correction in a bookkeeping entry as the basis for a tax where none was due. As said by Judge Woodrough, speaking for this court in Ruben v. Commissioner, 97 F. 2d. 926, "taxation remains a practical matter."

In Helvering v. Gordon, 87 F. 2d, 665, we said "substance and not form should control in the application of tax laws." A claim for taxes is in the nature of a claim for money had and

received, and can be maintained only where the party against whom the claim is asserted has money, which in equity and good conscience belongs to the other party. Here the Government is confessedly, wrongfully, and as the Supreme Court has said "immorally," holding funds belonging to the taxpayer. There was in fact nothing due the Government and if, under such circumstances, the Board is powerless to prevent an injustice, then it must disregard substance and be governed by form.

It is inconceivable that the latter part of this statute should be intended to take away from the Board the authority conferred by the earlier provisions. The limitation, we think, should be strictly construed. Ryan v. Carter, 93 U. S. 942; B. & O. S. M. Ry. Co. v. U. S., 242 F. 420. Otherwise the statute repeals itself. It confers broad authority but says such authority shall not be exercised. "Rules of practice and procedure are devised to promote the ends of justice, not to defeat them. * * *. Orderly rules of procedure do not require sacrifice of the rules of fundamental justice." Hormel v. Helvering, supra.

The limitation deprives the Board of authority to "determine" that the tax of any other year has been overpaid or underpaid. While the Board may examine thoroughly into the taxes for other taxable years, in doing so, it may not enter any judgment or decision for or against either party as to their liabilities or rights as to other tax years. The statute says it may not "determine" underpayment or overpayment for other years. One of the usual meanings of the word "determine" is: to decide; judge; adjudicate on an issue presented; to come to a decision; perform a judicial act. Tracy v. McIntyre, (Cal.) 84 P. 2d [illegible] Glenn v. Mitchell, (Colo.) 207 P. 84; In re Talbot's Will, [illegible] S. 2d, 806. The Board was not required to "determine" [illegible]nt of taxes for 1935; it only needed to consider the [illegible] inventory which normally should have been used for [illegible] years.

Board of Tax Appeals, as well as other administrative [illegible]nals, is of recent origin. It functions in the twilight zone. While it is an administrative agency, Congress has conferred upon it judicial, or at least quasi judicial, authority. Its jurisdiction as affected by rules of procedure was not definitely charted, nor was it clear that it would be bound by judicial precedent. Congress has seen fit to permit it to examine thoroughly into the taxes for other taxable years in order to make a proper redetermination of the taxes due for the year or years at issue, but, out of an abundance of precaution, Congress limited the Board by forbidding it to enter any judgment or decision for or against either party as to their liabilities or rights touching other taxable years. Decisions of the Board may be res

judicata on issues tried. A court need not be limited by express statute as to the issues it may hear. Centuries of judicial precedents, and construction compelled by practical necessity, limit its inquiry to the particular issue tendered by the parties. The limitation in this statute is a precaution to a tribunal not strictly judicial that it must not "determine" any tax liability other than for the years to which issue is tendered so as to result in any decision which binds as to those other years.

In any event this court may apply the correct rule of law to the facts as was done in Bull v. U. S., supra, and Crossett Lumber Co. v. U. S. supra. This court has power to affirm, or if the decision of the Board is not in accordance with law, to modify or reverse the decision with or without remanding the case for a rehearing "as justice may require." This we did in Helvering v. Hormel, 8th Cir., 111 F. 2d 1, and the Supreme Court affirmed. Hormel v. Helvering, 312 U. S. 552. In the Hormel case the Supreme Court said "there may always be exceptional cases or particular circumstances which will prompt a reviewing or appellate court, where injustice might otherwise result, to consider the questions of law which were neither pressed nor passed upon by the court or administrative agency below."

In the instant case the doctrine of recoupment was in fact pressed upon the Board. But if we have the right to consider the question if it had not been so presented to or passed upon by the Board, the fact that it was so presented cannot deprive this court of the power to apply it here "as justice may require."

The order appealed from is, therefore, reversed and the cause is remanded to The Tax Court of the United States as successor to the Board of Tax Appeals for further proceedings consistent herewith.

WOODROUGH, Circuit Judge, Dissenting.

It appears in this case that the taxpayer received net income of $93,828.83 for the fiscal year 1936 and that the tax liability to which it became subject under the applicable revenue act was $14,951.83. The return which it made for the year was untrue and the Commissioner was required to and did determine deficiency which properly adjusted the tax to the true income. But the taxpayer appealed from the deficiency determination to the Board of Tax Appeals. It was there established that the income determined by the Commissioner was the true income for 1936 and that the tax was rightly computed, but the taxpayer alleged that it had been overassessed and had overpaid its taxes in former years and it called upon the Board to determine such overpayments and to allow a credit for the amount thereof on the tax for 1936.

The Board is given broad powers to consider such facts with relation to the taxes for other taxable years as may be necessary

to correctly determine the amount of a deficiency brought before it for review, but by the statute which created the Board in 1924 and has governed it ever since the Board is expressly prohibited from determining whether or not a tax for any other tax year has been overpaid or underpaid. The statute says that the Board "in so doing (i. e., in considering facts related to the taxes for other taxable years) shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid." 26 U. S. C. A. 272 (g). Complying with that statute, the Board refused to consider the taxpayer's claim for credit for overpayment in prior years, as it has consistently done in like cases since its creation, on the ground that it had no jurisdiction.

The words of the statute forbidding the Board "to determine whether or not the tax for any other taxable year has been overpaid or underpaid" are so plain and unambiguous that no court has been called upon to construe or discuss them. The Seventh Circuit in stating the limitation upon the Board's powers stated it simply in the above quoted words of the statute (Commissioner v. Forest Glen Creamery Co., 7 Cir., 98 F. 2d 968), and the Supreme Court, with the same provision in mind, merely observed that the Board's jurisdiction is "limited to the determination of the amount of deficiency" and that the Board "is without authority * * * to order a credit." (U. S. ex rel. Girard Trust Co. v. Helvering, 301 U. S. 540, loc. cit. 542).

The statute, the Board's consistent obedience to it for nearly ...enty years, the courts' recognition of it and the acquiescence of ... profession have established an administrative system where ...xpayer may appeal to the Board from a deficiency found in ...ear with assurance that the Board cannot use a former ...nderpayment to defeat him and where both the taxpayer ...overnment know that the tax for the year of the defi... the only tax the Board can adjudicate. The system is ...plete, there being other equally certain means, administrative and judicial, to correct over and under assessments or payments in other years.

But of course all the Revenue Acts include limitation of action provisions.

On the review in this court the taxpayer renews its claim of right to have the Board determine the amounts alleged to have been overpaid in former years and credit them on the 1936 deficiency. The arguments in support seem to me to propose a new system for the Board, but on careful consideration of all that has been said neither the new system nor the arguments have appealed to me. Though it is not so stated by it, the petitioner's claim of injustice is really an attack upon the statute of limitations. The taxpayer's untrue returns in prior years, accepted by

the tax collector, caused it to be overtaxed in those years. It had all the time given it by law to obtain correction. But it took no steps within the time allowed. The same limitation applies to all taxpayers alike. It is a lawful limitation, and if unjust to this or any other taxpayer may be changed by Congress but not by the Board or by this court on review of the Board.

The incorrect items of its returns which caused this taxpayer to be overtaxed in years prior to 1936 were the amounts ascribed to inventory, an element in the returns of thousands of taxpayers which is especially subject to erroneous statement. But where overpayment results from the taxpayer's untrue statement the Board cannot say that the government receives the excess upon any continuing trust to offset or credit it on a lawful tax in some later year. On the contrary, it must leave the overpayment to be recovered from the government under the procedure provided by law and not otherwise. It cannot discriminate.

As I see it, the Commissioner having taken the true inventory figure and having rightly computed the taxpayer's true income and lawful tax in the 1936 deficiency, the Board of Tax Appeals was prohibited from finding an overpayment in former years or giving any credit on that account against the deficiency. I would affirm the Board's denial of jurisdiction.

A true copy.
Attest:
[SEAL] E. E. KOCH.
*Clerk, U. S. Circuit Court of Appeals,*
*Eighth Circuit.*

*Judgment*

United States Circuit Court of Appeals, Eighth Circuit

No. 12372—January Term, 1943

Friday, January 29, 1943

GOOCH MILLING AND ELEVATOR COMPANY, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE

On Petition to Review Decision of United States Board of Tax Appeals

This cause came on to be heard on the petition to review a decision of the United States Board of Tax Appeals determining a deficiency in income and excess profit taxes of the petitioner for

the fiscal year ended June 30, 1936; in the respective amounts of $4,731.69 and $1,931.73, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby, reversed without the taxation of costs in favor of either of the parties in this Court.

And it is further Ordered by this Court that this cause be, and the same is hereby, remanded to The Tax Court of the United States as Successor to the United States Board of Tax Appeals for further proceedings consistent with the opinion of this Court this day filed herein.

JANUARY 29, 1943.

*Clerk's Certificate*

United States Circuit Court of Appeals, Eighth Circuit

I, E. E. Koch, Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, do hereby certify that the foregoing contains the printed transcript of record on which the petition to review the decision of the United States Board of Tax Appeals was heard in said Circuit Court of Appeals, and full, true and complete copies of the pleadings, record entries and proceedings, including the opinion, had and filed in the United States Circuit Court of Appeals, except the full captions, titles and endorsements omitted in pursuance of the rules of the Supreme Court of the United States, in a certain cause in said Circuit Court of Appeals wherein Gooch Milling & Elevator Company was Petitioner and the Commissioner of Internal Revenue was Respondent, No. 12372.

I do further certify that on the 16th day of February, A. D. 1943, a mandate was issued out of said Circuit Court of Appeals in said cause, directed to The Tax Court of the United States as successor to the United States Board of Tax Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of the United States Circuit Court of Appeals for the Eighth Circuit, at office in the City of St. Louis, Missouri, this 18th day of March A. D. 1943.

[SEAL]

E. E. KOCH.
*Clerk of the United States Circuit Court of Appeals for the Eighth Circuit.*

U. S. GOVERNMENT PRINTING OFFICE: 1943

Supreme Court of the United States

*Order allowing certiorari*

Filed June 1, 1943

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsement on cover.] File No. 47473. U. S. Circuit Court of Appeals, Eighth Circuit. Term No. 972. Guy T. Helvering, Commissioner of Internal Revenue, Petitioner vs. Gooch Milling & Elevator Company. Petition for a writ of certiorari and exhibit thereto. Filed April 28, 1943. Term No. 972 O. T. 1942.

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# In the Supreme Court of the United States

OCTOBER TERM, 1942

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

GOOCH MILLING & ELEVATOR COMPANY

*PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT*

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Eighth Circuit, entered on January 29, 1943, reversing the decision of the United States Board of Tax Appeals.

## OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 12–14) is unreported. The opinions of the Circuit Court of Appeals (R. 27–38) are reported in 133 F. 2d 131.

## JURISDICTION

The judgment of the Circuit Court of Appeals was entered on January 29, 1943 (R. 38). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTION PRESENTED

The Commissioner determined a deficiency in taxes for the fiscal year ending June 30, 1936, by adjustment of inventories, and the taxpayer appealed to the Board of Tax Appeals from the determination. Taxpayer alleged that there had been an overpayment for the fiscal year 1935 and applied to the Board for offset against the deficiencies for 1936. The question presented is whether the Board has jurisdiction to determine and to apply any overpayment of tax for the fiscal year 1935 against the deficiencies in tax for the fiscal year 1936.

## STATUTES INVOLVED

The applicable statutes are set out in the Appendix, *infra*, pp. 10–12.

## STATEMENT

The taxpayer is a corporation (R. 13). Following the death of its president on June 11, 1938, an audit of the company's books disclosed that all inventories as far back as 1928 had been erroneously overstated. The reduced inventory for the fiscal year ended June 30, 1936, was

computed by the taxpayer's accountants and was accepted by the Commissioner as the basis for determining deficiencies in income tax of $4,731.69, and in excess profits tax of $1,931.73, for the fiscal year 1936. (R. 12–14.)

On its income tax return for the fiscal year 1936, the taxpayer had reported a net loss of $5,533.47. The Commissioner reduced the opening inventory at July 1, 1935, by $237,104.33 and the deficiencies result primarily from that adjustment. (R. 13.)

Based upon corrected inventories, the taxpayer had overpaid its income taxes for all the fiscal years 1928 to 1934, inclusive, in excess of $8,000. A revenue agent's report for the fiscal year 1935 showed an overassessment of $7,935.58. The refund of this amount, however, was barred by the statute of limitations. (R. 14.)

Taxpayer's original petition to the Board (R. 3) alleged that there were no deficiencies in income and excess profits taxes for the fiscal year ending June 30, 1936, claimed a refund due of $8,288.43, and alleged that the Commissioner had erroneously reduced the taxpayer's inventory at June 30, 1935, in the aggregate amount of $238,277.63, which was added to the taxpayer's income for the fiscal year ended June 30, 1936, but was not deducted from the taxpayer's income for the fiscal year ended June 30, 1935 (R. 6, 13). On April 30, 1941, the taxpayer filed a motion with the Board requesting leave to file an amended petition which repeated the allegations of the original

petition and added paragraphs 3½, 4a½ and 4½ (R. 3).

The amended petition (R. 5–8) alleged that if the adjusted inventory used by the Commissioner for the fiscal year ended June 30, 1936, were used in computing the taxable income for the fiscal year ended June 30, 1935, there would be a net loss for 1935 and an overassessment of the entire amount ($11,038.73) of the tax paid for that year (R. 6–7). The amended petition requested that the overassessment for the fiscal year 1935, a year which was not before the Board, be applied as an offset or recoupment against the deficiencies in tax found for the fiscal year 1936 (R. 8).

The amended petition was lodged with the Board and the motion for leave to amend was taken under advisement pending consideration of the case on its merits. The Commissioner objected to the filing of the amended petition upon the ground that the Board was without jurisdiction to consider the matters therein contained which related to tax liability for the fiscal year ended June 30, 1935, a year in which no deficiency in tax had been found by the Commissioner. (R. 13.)

The Board held that it had no jurisdiction to apply the doctrine of equitable recoupment and denied the motion for leave to file the amended petition (R. 14). The court below (R. 27), one judge dissenting (R. 36), reversed the Board and remanded the case for further proceedings. This

will require the Board to determine, by an adjustment of inventories for the fiscal year ending June 30, 1935, whether there was an overpayment of tax for that fiscal year and, if so, to offset the overpayment against the deficiencies in taxes found for the fiscal year ending June 30, 1936, the only tax year before the Board.

### SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the Board of Tax Appeals has jurisdiction to apply an overpayment of tax for the fiscal year ending June 30, 1935, a year where no deficiency in tax had been found by the Commissioner and no appeal had been taken to the Board, against deficiencies in tax found for the fiscal year ending June 30, 1936.

2. In holding that the Board of Tax Appeals has jurisdiction to determine an overpayment of tax for a year in which no deficiency in tax had been found by the Commissioner.

3. In holding that the Board of Tax Appeals has jurisdiction to apply the equitable doctrine of recoupment or set-off.

4. In reversing the decision of the Board of Tax Appeals.

### REASONS FOR GRANTING THE WRIT

The question presented involves a basic issue of the power and jurisdiction of the Board of Tax Appeals, and is a question of general importance in the administration of the tax laws. Congress

has provided and this and other courts, and the Board itself, have long considered, that the Board has no power to apply the doctrine of recoupment, and has no jurisdiction to determine an overpayment of taxes for a year which is not before the Board. In holding to the contrary, in a divided decision, the court below has unsettled a question of the Board's power and jurisdiction and of the general scheme of tax litigation which heretofore has been considered to be well accepted.

The Board of Tax Appeals[1] is a tribunal whose jurisdiction is limited by statute to the taxable year in which a notice of deficiency in tax has been mailed by the Commissioner and a petition has been filed by the taxpayer with the Board. Section 272 (a) of the Revenue Acts of 1934 and 1936 (Appendix, *infra*); *United States ex rel. Girard Co.* v. *Helvering*, 301 U. S. 540, 542. The Board may determine an overpayment in tax only in respect of a taxable year in which the Commissioner has determined a deficiency in tax. *United States ex rel. Girard Co.* v. *Helver-*

[1] The name of the Board of Tax Appeals was changed to The Tax Court of the United States, effective October 22, 1942, by Section 504 (a) of the Revenue Act of 1942, Public Law 753, 77th Cong., 2d Sess., amending Section 1100 of the Internal Revenue Code. But Section 504 (b) of the Revenue Act of 1942 provided that the jurisdiction powers and duties shall be the same as provided by existing law in the case of the Board of Tax Appeals. See H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 172–173; H. Conference Rep. No. 2586, 77th Cong., 2d Sess., p. 72.

*ing, supra; Morrison Woolen Co.* v. *Commissioner,* 10 B. T. A. 8, 9; *Stanfield* v. *Commissioner,* 8 B. T. A. 787, 819. The Board has no jurisdiction unless a deficiency in tax is found by the Commissioner. Section 322 (d) of the Revenue Acts of 1934 and 1936 (Appendix, *infra*). The Board in redetermining a deficiency in respect of any taxable year is authorized to consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency "but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid." Section 272 (g) of the Revenue Acts of 1934 and 1936 (Appendix, *infra*); *Commissioner* v. *Forest Glen C. Co.,* 98 F. (2d) 968 (C. C. A. 7), certiorari denied, 306 U. S. 639; *Greenleaf Textile Corp.* v. *Commissioner,* 26 B. T. A. 737, affirmed, 65 F. 2d 1017 (C. C. A. 2).

In holding that the Board's jurisdiction extends to all cases of an overpayment of a tax for any year, as long as the taxpayer is before the Board contesting a deficiency covering a different year, the majority of the court below thus ran counter to the unambiguous terms of the statute. Principles which are not reconcilable with those of the court below have been enunciated. In *United States ex rel. Girard Co.* v. *Helvering,* 301 U. S. 540, this Court held that the Board of Tax Appeals was without jurisdiction to order a refund

or credit of overpayment of taxes but is limited to the determination of the amount of a deficiency or overpayment upon the petition of a taxpayer to review a deficiency in tax found by the Commissioner. In point, too, is *Commissioner* v. *Forest Glen C. Co.*, 98 F. 2d 968, 970 (C. C. A. 7), certiorari denied, 306 U. S. 639, in which it was held that where the Commissioner had determined a deficiency in tax for one taxable year, the Board, on an appeal to it from such determination, lacked jurisdiction to determine the tax for another taxable year.

The Board has consistently and uniformly denied its jurisdiction in such cases. It had held that it has no jurisdiction of overpayments,[2] and it has denied its power to allow recoupment or set-off of taxes overpaid, for any year other than that for which a deficiency in tax has been determined by the Commissioner.[3] The holding of the court below overrules these principles long estab-

[2] *Will County Title Co.* v. *Commissioner*, 38 B. T. A. 1396, 1397; *Union Telephone Co.* v. *Commissioner*, 41 B. T. A. 152, 153; *Cornelius Cotton Mills* v. *Commissioner*, 4 B. T. A. 255, 256–257; cf. *United States ex rel. Girard Co.* v. *Helvering*, *supra*.

[3] *Red Wing Potteries, Inc.*, v. *Commissioner*, 43 B. T. A. 841, 845–846; *Heyl* v. *Commissioner*, 34 B. T. A. 223; *Jones* v. *Commissioner*, 34 B. T. A. 280; *Gould-Mersereau Co.* v. *Commissioner*, 21 B. T. A. 1316; *B. T. Couch Glue Co.* v. *Commissioner*, 12 B. T. A. 1321; *Ribbon Cliff Fruit Co.* v. *Commissioner*, 12 B. T. A. 13; *Cornelius Cotton Mills* v. *Commissioner*, 4 B. T. A. 255; cf. *Jones* v. *Commissioner*, 34 B. T. A. 280.

lished by the Board in delimiting its own jurisdiction.

## CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted.

CHARLES FAHY,
*Solicitor General.*

APRIL 1943.

## APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 271. DEFINITION OF DEFICIENCY.

As used in this title in respect of a tax imposed by this title "deficiency" means—

(a) The amount by which the tax imposed by this title exceeds the amount shown as the tax by the taxpayer upon his return; but the amount so shown on the return shall first be increased by the amounts previously assessed (or collected without assessment) as a deficiency, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; * * *.

* * * * *

SEC. 272. PROCEDURE IN GENERAL.

(a) *Petition to Board of Tax Appeals.*—If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this title, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within 90 days after such notice is mailed (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day), the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. * * *

* * * * *

(g) *Jurisdiction Over Other Taxable Years.*—The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the

taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

* * * * *

SEC. 322. REFUNDS AND CREDITS.

* * * * *

(d) *Overpayment Found by Board.*—If the Board finds that there is no deficiency and further finds that the taxpayer has made an overpayment of tax in respect of the taxable year in respect of which the Commissioner determined the deficiency, the Board shall have jurisdiction to determine the amount of such overpayment, and such amount shall, when the decision of the Board has become final, be credited or refunded to the taxpayer. No such credit or refund shall be made of any portion of the tax unless the Board determines as part of its decision that it was paid within three years before the filing of the claim or the filing of the petition, whichever is earlier.

* * * * *

The corresponding sections of the Revenue Act of 1936, c. 690, 49 Stat. 1648, are the same as the above sections of the Revenue Act of 1934.

Revenue Act of 1942, Public Law 753, 77th Cong., 2d Sess:

SEC. 504. CHANGE OF NAME OF BOARD OF TAX APPEALS.

(a) *The Tax Court of the United States.*—Effective on the day after the date of enactment of this Act, section 1100 (relating to status of Board of Tax Appeals) is amended by inserting at the end thereof

the following new sentence: "The Board shall be known as The Tax Court of the United States and the members thereof shall be know as the presiding judge and the judges of The Tax Court of the United States."

(b) *Powers, Tenure, Etc., Unchanged.*—The jurisdiction, powers, and duties of The Tax Court of the United States, its divisions and its officers and employees, and their appointment, including the designation of its officers, and the immunities, tenure of office, powers, duties, rights, and privileges of the presiding judge and judges of The Tax Court of the United States shall be the same as by existing law provided in the case of the Board of Tax Appeals. * * *

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| H. Conference Rep. No. 2586, 77th Cong., 2d Sess., p. 72 (1942–2 Cum. Bull. 701) | 12 |
| H. Rep. No. 179, 68th Cong., 1st Sess., pp. 7–8 (1939–1 Cum. Bull. (Part 2) 241) | 8, 9, 17 |
| H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 172–173 (1942–2 Cum. Bull. 372) | 12 |
| Magill, *The Impact of Federal Taxes*, 201 | 17 |
| 9 Mertens, *Law of Federal Income Taxation*, Sec. 50.10 | 12 |
| Restatement, Judgments, c. 3, Introductory note; Sec. 47, comment e | 21 |
| Rules of Practice Before the United States Board of Tax Appeals (17th Ed.), Rule 2 | 17 |
| S. Rep. No. 398, 68th Cong., 1st Sess., pp. 8–9 (1939–1 Cum. Bull. (Part 2) 266) | 9 |
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# In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 53

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

GOOCH MILLING & ELEVATOR COMPANY

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT*

## BRIEF FOR THE PETITIONER

### OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 10–12) is unreported. The opinions of the Circuit Court of Appeals (R. 21–32) are reported in 133 F. 2d 131.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered on January 29, 1943 (R. 32–33). The petition for a writ of certiorari was filed on April 28, 1943, and was granted on June 1, 1943. The jurisdiction of this Court rests upon Section

240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

## QUESTION PRESENTED

The Commissioner determined deficiencies in income and excess profits taxes for the fiscal year ending June 30, 1936, by adjustment of the taxpayer's opening inventories. The taxpayer appealed to the Board of Tax Appeals from that determination alleging that the adjustment of inventories resulted in an overpayment of its taxes for the fiscal year ending June 30, 1935, which it requested the Board to offset against the deficiencies for 1936. The question presented is whether the Board has jurisdiction to determine and to apply any overpayment of tax for the fiscal year 1935 against the deficiencies for the fiscal year 1936.

## STATUTES INVOLVED

The applicable statutes are set out in the Appendix, *infra*, pp. 29–32.

## STATEMENT

The respondent taxpayer is a corporation which files its returns on the basis of a fiscal year ending on June 30. Following the death of its president on June 11, 1938, an audit of its books disclosed that all inventories as far back as 1928 were erroneous. The taxpayer's balance sheet for the year 1936 shows an opening inventory of $361,701.88 and a closing inventory of $345,017.43.

The Commissioner reduced the opening inventory by $237,104.33. The reduced inventory was first computed by the taxpayer's accountant and was accepted by the Commissioner as the basis for his computation of tax for the fiscal year 1936. The deficiencies here involved result primarily from this adjustment of inventory. The deficiencies so computed amount to $4,731.69 in income tax and $1,931.73 in excess-profits tax. (R. 10–11.)

Based upon corrected inventories, the taxpayer had overpaid its income taxes for all the fiscal years 1928 to 1934, inclusive, in excess of $8,000. A revenue agent's report for the fiscal year 1935 showed an overassessment of $7,935.58. The refund of this amount, however, was barred by the statute of limitations. (R. 11.)

Taxpayer's original petition to the Board (R. 3) alleged that there were no deficiencies in income and excess profits taxes for the fiscal year ending June 30, 1936, claimed a refund due of $8,288.43, and alleged that the Commissioner had erroneously reduced the taxpayer's inventory at June 30, 1935, in the aggregate amount of $238,277.63, which was added to the taxpayer's income for the fiscal year ended June 30, 1936, but was not deducted from the taxpayer's income for the fiscal year ended June 30, 1935 (R. 4–63. On April 30, 1941, pursuant to a motion filed ten days earlier (R. 1), the taxpayer filed with the Board an amended petition which repeated the allegations

of the original petition and added paragraphs 3½, 4a½ and 4½ (R. 4–6).

The amended petition alleged that if the adjusted inventory used by the Commissioner for the fiscal year ended June 30, 1936, were used in computing the taxable income for the fiscal year ended June 30, 1935, there would be a net loss for 1935 and an overassessment of the entire amount ($11,038.73) of the tax paid for that year (R. 5–6). The amended petition requested that the overassessment for the fiscal year 1935, a year which was not before the Board, be applied as an offset or recoupment against the deficiencies in tax found for the fiscal year 1936 (R. 6).

The amended petition was lodged with the Board and the motion for leave to amend was taken under advisement pending consideration of the case on its merits. The Commissioner objected to the filing of the amended petition upon the ground that the Board was without jurisdiction to consider the matters therein contained which related to tax liability for the fiscal year ended June 30, 1935, a year in which no deficiency in tax had been found by the Commissioner. (R. 10.)

The Board held that it had no jurisdiction to apply the doctrine of equitable recoupment and denied the motion for leave to file the amended petition (R. 11). The court below (R. 21), Judge Woodrough dissenting (R. 30), reversed the Board and remanded the case for further proceedings.

This will require the Board to determine, by an adjustment of inventories for the fiscal year ending June 30, 1935, whether there was an overpayment of tax for that fiscal year and, if so, to offset the overpayment against the deficiencies in taxes found for the fiscal year ending June 30, 1936, the only tax year before the Board.

## SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the Board of Tax Appeals has jurisdiction to apply an overpayment of tax for the fiscal year ending June 30, 1935, a year in which no deficiency in tax had been found by the Commissioner and no appeal had been taken to the Board, against deficiencies in tax found for the fiscal year ending June 30, 1936.

2. In holding that the Board of Tax Appeals has jurisdiction to determine an overpayment of tax for a year in which no deficiency in tax had been found by the Commissioner.

3. In holding that the Board of Tax Appeals has jurisdiction to apply the equitable doctrine of recoupment or set-off.

4. In reversing the decision of the Board of Tax Appeals.

## SUMMARY OF ARGUMENT

The Board of Tax Appeals (now The Tax Court of the United States) is an administrative

agency in the executive branch of the Government, not a court. It has no powers other than those specifically conferred upon it by statute; it has no general jurisdiction or equity power. And it was never designed to be an agency to settle generally the tax account between an individual and the Government.

The sole function of the Board is to review certain restricted classes of proposed assessments of additional taxes before the assessments are made. Before the Board can act at all, it is necessary that the Commissioner shall have made a determination of a deficiency and shall have notified the taxpayer thereof. If these steps have been taken and a petition for review of the Commissioner's determination is filed with the Board, then, with respect to income taxes, that body may determine the correct tax liability for the year as to which such a determination has been made. But it has no other function. The statute specifically provides that it shall be without jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

We submit that since the Board is without power to determine the tax liability for any year other than the year before it, and since in the instant case the only year before it was the fiscal year 1936, it must be plain that the Board is without power to apply any overpayments for prior years

against the liability for the fiscal year 1936. This view is supported by the words and scheme of the statute, by the decisions of this Court and by the consistent and uniform decisions of the Board itself since the enactment of the Revenue Act of 1926.

## ARGUMENT

### THE BOARD OF TAX APPEALS IS WITHOUT JURISDICTION TO APPLY AN OVERPAYMENT OF TAX FOR A YEAR IN WHICH NO DEFICIENCY HAS BEEN DETERMINED BY THE COMMISSIONER AGAINST THE LIABILITY FOR A YEAR IN WHICH THE COMMISSIONER HAS DETERMINED A DEFICIENCY

This case involves the income and excess-profits tax liability of the respondent taxpayer for the fiscal year ended June 30, 1936. That is the *only* year for which the Commissioner has determined any deficiencies, a fact which we think is of controlling importance in view of the sharply defined limitations upon the jurisdiction and power of the Board of Tax Appeals. For purposes of this case it may be assumed, *arguendo,* that the taxpayer has overpaid its tax for the fiscal year ended June 30, 1935. The decisive point here is that the Board of Tax Appeals, in determining the taxpayer's liability for 1936, is without jurisdiction to determine any alleged overpayments for other years and subtract them from the 1936 taxes.

This result follows from the narrowly circumscribed powers which Congress has committed to the Board, and it is wholly irrelevant that relief by the way of equitable recoupment might be available if the proceedings were initiated in a court having general equity powers.[1]

The basic scheme of federal tax collection is one of assessment and payment first and litigation, if any, afterward. *Bull v. United States,* 295 U. S. 247, 259, 260. With respect to income taxes the taxpayer initially assesses himself in filing his return and pays the tax accordingly. If the Commissioner thinks the taxpayer has set the figure too low he assesses an additional amount. As in the case of the initial self-assessment, payment of the additional assessment is due immediately and is subject to collection by the usual methods, including distraint. Historically, the taxpayer's only judicial remedy, if he thought he had been wronged, was to bring an action in the District Court or in the Court of Claims to recover the overpayment. It was early recognized, however, that in the field of income taxation the remedy of suit to recover an overpayment was inadequate, and in many cases failed to mitigate hardships occasioned by an incorrect additional assessment. See H. Rep. No. 179, 68th Cong., 1st Sess., pp. 7–8 (1939–1 Cum. Bull. (Part 2) 241,

[1] However, it is doubtful whether such relief could be had in this case, even in the proper forum. See p. 28, *infra.*

246–247); S. Rep. No. 398, 68th Cong., 1st Sess., pp. 8–9 (1939–1 Cum. Bull. (Part 2) 266, 271–272). Accordingly, there was established in the Bureau of Internal Revenue in 1919 the Committee on Appeals and Review to hear appeals by taxpayers from proposed additional assessments.[2] And Section 250 (d) of the Revenue Act of 1921, c. 136, 42 Stat. 227, provided that, prior to payment of a deficiency found by the Commissioner, a taxpayer might file an appeal, within thirty days after notice by the Commissioner, and show cause why the deficiency should not be paid. Such appeals were handled by the Committee on Appeals and Review.[3]

The Committee on Appeals and Review was, of course, an integral part of the Bureau of Internal Revenue. In order to afford taxpayers an independent consideration, the Board of Tax Appeals was created by Section 900 of the Revenue Act of 1924, c. 234, 43 Stat. 253. That Act provided that when the Commissioner determined a deficiency in income, estate, or gift taxes, notification thereof should be sent to the taxpayer by registered mail, prior to the making of the assessment.

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[2] A somewhat similar function had previously been performed by the Advisory Tax Board which existed from March 13, 1919 to October 1, 1919. See *Williamsport Co.* v. *United States*, 277 U. S. 551, 562, note 7.

[3] *Ibid.* See also H. Rep. No. 179, 68th Cong., 1st Sess., p. 7 (1939–1 Cum. Bull. (Part 2) 241, 247); S. Rep. No. 398, 68th Cong., 1st Sess., p. 8 (1939–1 Cum. Bull. (Part 2) 266, 272).

The term "deficiency" was defined as the amount by which the proper tax exceeded the tax shown on the return. Within sixty days from the mailing of the notice the taxpayer could file an appeal with the Board of Tax Appeals, and the assessment was not to be made until the Board had rendered its decision. Sections 273, 274, 308. A decision of the Board was not binding upon either party. If it decided in favor of the Commissioner he was then free to make an assessment and proceed with the collection of the tax, but the taxpayer could thereafter sue for a refund in the usual manner. Similarly, the Commissioner could sue to establish an additional liability not found by the Board. In any subsequent court action the findings of the Board were only "prima facie evidence of the facts therein stated" [Section 900 (g)], and the issues were retried *de novo*.

The system set up under the Revenue Act of 1924 was found to be unsatisfactory in several respects and certain changes were made by the Revenue Act of 1926, c. 27, 44 Stat. 9. The Board was empowered by that Act to decide not only whether the deficiency determined by the Commissioner was correct or was excessive, but also whether there was an overpayment instead of a deficiency [Sections 284 (e) and 319 (c)] or, that the deficiency was greater than that originally determined by the Commissioner [Sections 274 (e) and 308 (e)]. The Board's decision was made

subject to review by the Circuit Courts of Appeals and thereafter by this Court [Sections 1000–1005] and until the decision of the Board became final, the Commissioner was precluded from proceeding with the assessment and collection of the deficiency [Sections 274 (a), 308 (a), and 1005]. When the Board's decision became final, the Commissioner was authorized to assess and collect the deficiency found by the Board [Sections 274 (b) and 308 (b)]. If it determined an overpayment instead of a deficiency, the overpayment thus determined was, when the decision became final, to be credited or refunded by the Commissioner in the same manner as other overpayments [Sections 284 (e) and 319 (c)].[4]

The pattern of the Board's function and jurisdiction has not since been altered.[5] It is plain from the statute and well settled that the fundamental prerequisite to the exercise of jurisdiction by the Board is the determination of a deficiency by the Commissioner and the mailing of a notice

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[4] Under later acts, however, the Board was required to determine whether a refund or credit was barred [Section 284 (e) as amended by Section 507 of the Revenue Act of 1928 and Section 504 (c) of the Revenue Act of 1934, c. 277, 48 Stat. 680, Section 322 (d) of the Internal Revenue Code; Section 319 (c) as amended by Section 810 of the Revenue Act of 1932, c. 209, 47 Stat. 169 and Section 504 (d) of the Revenue Act of 1934, Section 912 of the Internal Revenue Code.]

[5] See Section 272 of the Revenue Acts of 1928, 1932, 1934, 1936, 1938 and the Internal Revenue Code. The Revenue

thereof.[6] In the case of income taxes, if a deficiency notice has been mailed and a petition for review has been filed with the Board, the Board's authority extends to the point where it may determine the correct tax liability *for the year covered by the deficiency notice,* but it has no other jurisdiction whatsoever. It cannot determine an overpayment for a year for which no deficiency was asserted or direct the Commissioner to credit such an overpayment against any deficiency which it has determined.

To put the matter beyond dispute, Section 274 (g) of the 1926 Act (Section 272 (g) of the Internal Revenue Code) provides:

> The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary

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Act of 1934 extended the period for filing petitions with the Board to 90 days from the date of the mailing of the notice. By Section 504 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, 957, the name of the Board of Tax Appeals was changed to The Tax Court of the United States, as of October 22, 1942. But Section 504 (b) specifically provided that the change in name was to have no effect on the jurisdiction, powers and duties of the agency. See H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 172–173 (1942–2 Cum. Bull. 372, 498); H. Conference Rep. No. 2586, 77th Cong., 2d Sess., p. 72 (1942–2 Cum. Bull. 701, 727. The Tax Court has also been given Jurisdiction of processing tax refunds by Section 510 of the Revenue Act of 1942.

[6] See 9 Mertens, *Law of Federal Income Taxation*, Sec 50.10.

> correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

Thus it is plain that in the instant case the Board was without power to determine whether the taxpayer had overpaid or underpaid its taxes for any year other than the fiscal year ending June 30, 1936. We think it must be manifest that if the Board is lacking in the authority to make such a determination, it is clearly without power to take the next step, i. e., to apply overpayments of years not before it against the taxes due for the year before it. Therefore, even if it should be assumed that the respondent has overpaid its taxes for the fiscal year 1935, and even if it be further assumed that on principles of equity it should be allowed to apply that overpayment against its liability for the following year, it is plain that the Board is without authority to grant the relief. The Board can do no more than to determine the correct tax for the fiscal year 1936. Its function ceases at that point.

The court below erred in not recognizing that the fact that the correction in the inventory made by the Commissioner would result in an overpayment for the fiscal year ended June 30, 1935 (refund of which was barred by the statute of limitations), was not a fact that was material in the

determination of the deficiency for the fiscal year ended June 30, 1936. Each tax year stands alone. The Commissioner was not prohibited from asserting a deficiency because of the barred refund of the earlier year;[7] and the determination of the correct tax for 1936 by the Board was not dependent in any way on whether there was an overpayment for 1935 or on whether that overpayment could be refunded. Recoupment can be availed of, if at all, only after both tax liabilities are known, and not in the process of determining one of those liabilities. Hence the suggestion of the court below that the doctrine of recoupment could be applied here, even though the Board was prohibited by Section 274 (g) from determining an overpayment for the year 1935, is wholly without merit. In order to allow a recoupment, the Board would have to possess authority (1) to determine an overpayment for 1935 and (2) to permit that overpayment to be recouped from the 1936 deficiency.

We have endeavored to show that the Board possessed no authority to determine the overpayment. It was equally lacking in authority to di-

[7] The Commissioner is authorized merely to apply an overpayment for one year against an *assessment* for another year, whether the assessment is of a tax disclosed by the return or is an assessment made after the decision of the Board becomes final. And he cannot apply an overpayment, the refund of which is barred by the statute of limitations, against an assessment. Sections 322, 3774, 3775 of the Internal Revenue Code.

rect a recoupment. It is quite true that the Board was created for "great remedial purposes." *Helvering* v. *Taylor*, 293 U. S. 507, 516. But it was not created as, and was never intended to be, a general nostrum. Its purpose was to stay the collection of an additional assessment of income, estate or gift taxes until there had been a decision by an independent body that the additional tax was due. It has no authority to alter the general tax procedure of payment first and suit afterward, except in the one respect that restricted classes of assessments proposed by the Commissioner are reviewed before they are made. It was never designed to be an agency to settle generally the tax account between an individual and the Government. Jurisdiction to order a recoupment was in no way essential to, or consistent with, the purpose for which the Board was created.

The court below assumed that Congress intended the Board to exercise powers similar to those possessed by the District Courts in deciding tax controversies and hence that it possesses the power to order a recoupment. This argument disregards the fact that the Board is an "independent agency in the Executive Branch of the Government" [Section 900 (k) of the Revenue Act of 1924; Section 1000 of the 1926 Act (amending Section 900 of the Revenue Act of 1924); Section 1100 of the Internal Revenue Code], that it is specifically provided that the Board shall have such jurisdiction as is conferred upon it by

specific provisions of the internal revenue laws [Section 1000, Revenue Act of 1926 (amending Section 904 of the 1924 Act), Section 1101 of the Internal Revenue Code], that no internal revenue statute has conferred upon it the power to direct recoupment, and that it possesses no general jurisdiction or equity power. As this Court has several times pointed out (*Goldsmith* v. *Bd. of Tax Appeals*, 270 U. S. 117, 121-122; *Old Colony Tr. Co.* v. *Commissioner*, 279 U. S. 716; *Helvering* v. *Rankin*, 295 U. S. 123, 131), the Board is an administrative agency, not a court. It does not possess either the organization[8]

[8] The Board (now the Tax Court) consists of sixteen members appointed for twelve-year terms by the President, with the advice and consent of the Senate (the members being designated as judges by the Revenue Act of 1942). There are no particular qualifications for the office and the members are subject to removal by the President (after notice and opportunity for a public hearing) for inefficiency, neglect of duty, or malfeasance in office [Section 1102 of the Internal Revenue Code]. The Board elects a chairman (now designated as presiding judge) every two years [Section 1103]. Hearings are conducted by a division of the Board (usually one member) appointed by the Chairman, and the decision of the division becomes the decision of the Board, unless a review by the full Board is ordered by the Chairman [Sections 1103 and 1118]. The Board is required to report in writing its findings of fact, opinion, or memorandum opinion, and in a case where there is a review by the full Board, the findings may be made by a member other than the one conducting the hearing [Section 1117]. The hearing may be had anywhere in the United States [Section 1105], though the Board's principal office is in the District of Columbia [Section 1104]. Unlike courts, where litigants must be represented by members of the bar, taxpayers have

or the powers of a court." In *Old Colony Tr. Co.* v. *Commissioner, supra,* Chief Justice Taft said (p. 725):

been permitted to be represented before the Board by accountants or other properly qualified persons. See, e. g., Rules of Practice Before the United States Board of Tax Appeals (17th Ed.), Rule 2; Section 504 (b), Revenue Act of 1942, c. 619, 56 Stat. 798.

The Board follows such rules of practice and procedure as it may prescribe from time to time [Section 1111], being bound neither by common law rules of pleading and practice or by the Federal Rules of Civil Procedure. It is required to follow the rules of evidence formerly prevailing in the equity courts of the District of Columbia [Section 1111], but otherwise devises its own procedure. It was originally expected that the Board would have a flexible and informal procedure [H. Rep. No. 179, 68th Cong., 1st Sess., pp. 7–8, 1939–1 Cum. Bull. (Part 2) 241, 246–247], but the procedure which the Board developed has resulted in a hearing which has some of the aspects of a trial before a court without a jury. See Magill, *The Impact of Federal Taxes*, 207.

[9] The Board has no power to enforce its own judgments. *Old Colony Tr. Co.* v. *Commissioner*, 279 U. S. 716. If a deficiency which it determines is not paid, assessment and collection proceed in the usual manner. If it determines an overpayment which is not refunded by the Government, the taxpayer must sue. The Board may issue subpoenas but must resort to the courts to enforce them [Section 1114 of the Internal Revenue Code]. See also *Blair* v. *Oesterlein Co.*, 275 U. S. 220; and *United States* v. *Union Trust Co. of Pittsburgh*, 13 F. Supp. 286 (W. D. Pa.). It has no power to punish for contempt. On the other hand, because it is an administrative agency, rather than a court, the Board may review determinations of the Commissioner which are not reviewable by the courts, as for example the discretionary determinations of the Commissioner in special assessment cases. See *Blair* v. *Oesterlein Co.*, 275 U. S. 220, and cf. *Williamsport Co.* v. *United States*, 277 U. S. 551; *Heiner* v. *Diamond Alkali Co.*, 288 U. S. 502.

The Board of Tax Appeals is not a court. It is an executive or administrative board, upon the decision of which the parties are given an opportunity to base a petition for review to the courts after the administrative inquiry of the Board has been had and decided.

Recoupment is an equitable doctrine of limited application in tax controversies. When a taxpayer brings a suit in the District Court or Court of Claims to recover a refund from the Government, the action is in the nature of an action for money had and received. He is required to show that he is in equity and good conscience entitled to a refund and the Government may raise the same defenses as might be raised by any defendant in such a suit, including the defense of a recoupment arising out of the same transaction. *Stone* v. *White,* 301 U. S. 532; *Bull* v. *United States,* 295 U. S. 247. The defense is allowed, not because the case involves a tax, but because of the nature of the proceeding and of the fact that the court has power to permit a recoupment.

Recognition of the fact that the Board cannot allow a recoupment underlies the decision in *United States ex rel. Girard Co.* v. *Helvering,* 301 U. S. 540. The case was decided on the same day as *Stone* v. *White,* 301 U. S. 532. In both of those cases testamentary trustees had erroneously paid the tax on income of the trust when it should have been paid by the beneficiary. The

liabilities of the beneficiaries had been barred by the statute of limitations, and any refund to the trustees would have inured to the advantage of the beneficiaries.

In *Stone* v. *White* an action was brought in the District Court by the trustees against the Collector to recover the tax. The Court pointed out that since in such an action (p. 535) "* * * the plaintiff must recover by virtue of a right measured by equitable standards, it follows that it is open to the defendant to show any state of facts which, according to those standards, would deny the right, * * *." It was held that the right of the trustee to maintain the action was inextricably related to the fact that it was one (p. 536) "* * * for the benefit and in the equitable interest of the *cestui.*" And that (p. 538) "Since in equity the one taxpayer represents and acts for the other, it is not for either to complain that the government has taken from one with its right hand, when it has, because of the same error, given to the other with its left." The Government's defense was described (p. 539) as "* * * comparable to an equitable recoupment or diminution of petitioners' right to recover."

In the *Girard Co.* case the proceedings commenced in the Board of Tax Appeals which entered final orders determining that the amounts paid by the trustees as taxes for the years involved were overpayments. The Commissioner

refused to make the refund and the trustees petitioned for mandamus to compel the refund. The Court stated (pp. 542–543):

> The petition for mandamus is predicated upon the determination of the Board of Tax Appeals that petitioner has made overpayments of taxes for the specified years. The Board has not ordered a refund. It could not rightly do so, for its jurisdiction is limited to the determination of the amount of deficiency or overpayment, * * * upon the petition of the taxpayer to review a deficiency assessment by the Commissioner. The Board is without authority to order a refund or a credit, although its decision is *res adjudicata* as to the questions involved in the computation and assessment of taxes for which a deficiency is claimed. * * * When the determination of overpayment by the Board becomes final, the statute provides that such amounts shall be refunded or credited, * * * and upon the Commissioner's failure to comply with the statute, a plenary suit will lie in the district court or the Court of Claims, for the recovery of any refund to which he is entitled. * * * And in such a suit the Commissioner may secure a final adjudication of his right to withhold the overpayment determined by the Board, on the ground that other taxes are due from the taxpayer, or that upon other grounds he is not equitably entitled

> to the refund. See *Stone* v. *White*, *supra*; * * *.

For these reasons it was held that the appropriate remedy was an ordinary suit for a refund and not mandamus. It is to be noted that it is of the very essence of the decision that the Board was without authority to apply the equitable doctrine of recoupment. For if the defense had been available to the Commissioner in the proceedings before the Board, he would have been precluded, upon elementary principles of *res judicata* (see Restatement, Judgments, c. 3, Introductory note; Section 47, comment e), from raising it in a subsequent suit for refund. Indeed the holding was not only that the defense was available in such a later suit, but that it could not have been availed of in the earlier Board proceedings.

The Board of Tax Appeals has itself consistently and uniformly denied its jurisdiction in such a situation. In *Jones* v. *Commissioner*, 34 B. T. A. 280, which involved a situation like *Stone* v. *White* and the *Girard Co.* case, the Commissioner did raise the defense of equitable recoupment. But the Board held (p. 283):

> Proceedings before the Board are not for the recovery of money had and received. The Board has no authority to order the Commissioner to refund or credit amounts overpaid as taxes. This is so even though refund or credit seems to follow as

> a necessary consequence of a decision by the Board. * * * Collection, payment, credit and refund are matters over which the Board has no jurisdiction whatsoever, and which it has no reason to consider, except as they may affect the question of the correctness of the deficiency as determined by the Commissioner. The function of the Board in this case ends when it determines that in fact there has been an overpayment of a certain amount and that a claim for refund was filed within two years after the overpayment was made. The Commissioner's alleged defense is in opposition to the refunding of the overpayment, not to the fact of overpayment. * * *

Other illustrative cases in which the Board has denied its jurisdiction to do what the court below has directed it to do in the instant case are: *Cornelius Cotton Mills* v. *Commissioner,* 4 B. T. A. 255; *Dickerman & Englis, Inc.* v. *Commissioner,* 5 B. T. A. 633; *Ribbon Cliff Fruit Co.* v. *Commissioner,* 12 B. T. A. 13; *B. T. Couch Glue Co.* v. *Commissioner,* 12 B. T. A. 1321; *Gould-Mersereau Co.* v. *Commissioner,* 21 B. T. A. 1316; *Heyl* v. *Commissioner,* 34 B. T. A. 223; *Red Wing Potteries, Inc.* v. *Commissioner,* 43 B. T. A. 841. See also *Commissioner* v. *Forest Glen C. Co.,* 98 F. 2d 968 (C. C. A. 7th), certiorari denied, 306 U. S. 639; Clark, J. dissenting in *Lyeth* v. *Hoey,* 112 F. 2d 4, 10 (C. C. A. 2d).

The holding of the court below appears to be the only decision since the enactment of the

Revenue Act of 1926 in which a different rule has been announced.[10]

To be sure, the Board may consider facts relating to the taxes for other years in order to determine the proper tax for the year before it. Thus where the statute provides that net losses for one year may be carried over and deducted in the following year,[11] the Board might be required to determine whether a loss claimed for the earlier year was in fact sustained at that time;[12] in order to determine the invested capital of a corporation it might be necessary

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[10] The point lurked in *Dixie Margarine Co.* v. *Commissioner*, 115 F. 2d 445 (C. C. A. 6th). However, the question of the jurisdiction of the Board of Tax Appeals was neither briefed nor argued. And the court's opinion shows that it considered only whether the case was a proper one on the merits for the application of the doctrine of recoupment and whether the statute of limitations had any bearing, both of which points it resolved in favor of the taxpayer. The point was called to the court's attention for the first time in a petition for rehearing which the Government attempted to file out of time, but the court denied the Government's motion for leave to file the petition out of time. The Board thereupon entered its order in conformity with the mandate of the court. The Board denied the motion of the Commissioner to vacate its decision on jurisdictional grounds, and the Commissioner appealed. The Circuit Court affirmed on the ground that the Board's order was in conformity with the mandate. *Commissioner* v. *Dixie Margarine Co.*, 127 F. 2d 292 (C. C. A. 6th).

[11] E. g., Section 206 of the Revenue Acts of 1924 and 1926.

[12] *Greenleaf Textile Corp.* v. *Commissioner*, 26 B. T. A. 737, affirmed, 65 F. 2d 1017 (C. C. A. 2d); *Gottlieb Realty Co.* v. *Commissioner*, 28 B. T. A. 418.

to ascertain the tax liability for prior years;[13] in order to determine the base for depreciation of property it might be necessary to determine how much depreciation had been allowed or was allowable in prior years.[14] It is in situations such as these in which the provision allowing the Board to consider facts relating to others years finds its proper office. Events occurring in prior years may thus be relevant to the determination of the taxpayer's liability for the year in question and therefore may be considered by the Board to that extent. However, where rights of the taxpayer with respect to prior years cannot affect the determination of his correct taxes for the year under consideration, but simply constitute a potential offset in judicial proceedings, they may not be taken into account by the Board. Section 274 (g) explicitly provides that the Board "shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid," and the holding of the majority of the court below, that included among the facts relating to other years which the Board may consider is the "fact" that there is an overpayment for some other year is in plain conflict with the statute.[15]

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[13] *Cornelius Cotton Mills* v. *Commissioner*, 4 B. T. A. 225.

[14] Cf. *Virginian Hotel Corp.* v. *Commissioner*, decided by this Court on June 7, 1943, No. 766, 1942 Term.

[15] In *Barry* v. *Commissioner*, 1 B. T. A. 156, which arose under the 1924 Act, which contained no provision similar to Section 274 (g), the Board had held that it was within its

It is not disputed that the Commissioner's computation of the tax for 1936 based on the corrected inventories is correct. The holding below is that this liability must be mitigated because the correction of the inventories resulted in an overpayment of tax for another unit, 1935. The majority opinion below states that it was not necessary for the Board to determine the amount of taxes for 1935.[16] Yet it is appar-

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function to determine an overpayment for a year as to which no deficiency had been found by the Commissioner and to apply that overpayment against the liability for a year as to which such a deficiency had been determined. In that case, however, instead of asserting the full deficiency determined for the year 1921, the Commissioner had asserted a deficiency reduced by an overassessment for 1920. See comment on that case, in *Gress Manufacturing Co. v. Commissioner*, 3 B. T. A. 977, 981. Moreover, while the legislative history of the 1926 Act appears to shed no light on the point, it is a fair inference that Section 274 (g) was incorporated in that Act for the express purpose of achieving a legislative reversal of the *Barry* decision. And, as has been noted, the Board has consistently held that it has no jurisdiction to determine an overpayment and apply it against a deficiency since the enactment of the 1926 Act.

[16] The Court said (R. 28):

> The Board did not have to determine the amount of the taxes for 1935, it only needed to consider the effect of the change in the inventory which normally should have been the same for each year. Its investigation disclosed the fact that the corrected inventory should not in justice be resorted to in redetermining the tax for either of the years 1935 or 1936.

Insofar as the suggestion in the last sentence of this quotation is concerned we submit that the Commissioner was not only empowered but was impelled by duty to compute the tax for 1936 on the basis of the true facts. See the dissenting

ent that before there can be such an application of an overpayment, and before it can be decided that there is an overpayment it is necessary first to decide what the correct payment should have been, or in other words, what was the correct tax for 1935. For taxes are not imposed upon inventories; they are imposed upon the net income of which inventories are but one factor.[17] And it is precisely such a determination which Section 274 (g) enjoins the Board from making.

We submit that Judge Woodrough correctly stated the law when he said (R. 31):

> The statute, the Board's consistent obedience to it for nearly twenty years, the courts' recognition of it and the acquiescense of the profession have established an administrative system where the taxpayer may appeal to the Board from a deficiency found in any year with assurance that the Board cannot use a former year's underpayment to defeat him and where both the taxpayer and the govern-

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opinion of Judge Woodrough (R. 30): "The return which it made for the year [1936] was untrue and the Commissioner was required to and did determine deficiency which properly adjusted the tax to the true income."

[17] Paragraph 3½ of the taxpayer's amended petition to the Board states (R. 5):

"The Commissioner used an inventory July 1, 1935, of $123,424.25 in computing petitioner's taxable net income for the year ended June 30, 1936. If the same inventory is used June 30, 1935, in computing the taxable net income for the year ended June 30, 1935, *and no other adjustments are made*, there would be a net loss for the year and an overassessment of $11,038.73." [Italics added.]

> ment know that the tax for the year of the deficiency is the only tax the Board can adjudicate. The system is complete, there being other equally certain means, administrative and judicial, to correct over and under assessments or payments in other years.

It should not be assumed that because the Board has no general equity powers to permit a recoupment a taxpayer is wholly without a remedy. He may litigate in the district court or in the Court of Claims, instead of proceeding before the Board. Moreover, by the enactment of Section 820 of the Revenue Act of 1938 [Section 3801 of the Internal Revenue Code], Congress has provided comprehensive *administrative* machinery for the mitigation of the effect of the statute of limitations. And to the extent that a taxpayer is entitled to relief he may seek that relief from the Commissioner in accordance with those provisions.[18] Indeed the enactment of those provisions, if they throw any light at all upon the interpretation to be given to the Board's powers, indicate that Congress did not think that the Board possessed general equity powers. See S. Rep. No. 1567, 75th Cong., 3d Sess., pp. 48–52 (1939–1 Cum. Bull. (Part 2) 779, 814–817).

There is also considerable doubt, even if the Board has jurisdiction to order a recoupment, whether recoupment would be available here. At

[18] We do not suggest that Section 820 mitigates the effect of the statute of limitations in every situation, nor do we take any position as to whether it would apply here.

the time the Commissioner asserted the deficiency for the fiscal year 1936, in the spring of 1940 (R. 7), the period of limitations for the fiscal year 1935 had probably already run,[19] and even *Bull* v. *United States* makes it perfectly clear that recoupment in that case depended upon the fact that the taxpayer's right to refund was alive when the Government proceeded against him for the collection of the second tax. (295 U. S. at 263.)[20]

## CONCLUSION

The judgment below should be reversed.

Respectfully submitted.

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SEPTEMBER 1943.

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[19] The Board made no finding as to this, it being unnecessary upon its view as to the absence of jurisdiction to consider the point. However, since the period of limitations as to 1935 is governed by Section 322 of the Revenue Act of 1934, c. 277, 48 Stat. 680, which allows a maximum period of three years, it seems likely that the period had run here.

[20] Moreover, the doctrine of recoupment as set forth in the *Bull* case and *Stone* v. *White*, *supra*, is not available to the taxpayer, in any event, by reason of *McEachern* v. *Rose*, 302 U. S. 56. Although we think that the *McEachern* case is to some extent in conflict with *Stone* v. *White*, and that the latter represents the correct view, nevertheless, as long as the *McEachern* case stands without limitation it forbids the recoupment sought here.

## APPENDIX

Internal Revenue Code:

SEC. 271. DEFINITION OF DEFICIENCY.

As used in this chapter in respect of a tax imposed by this chapter "deficiency" means—

(a) The amount by which the tax imposed by this chapter exceeds the amount shown as the tax by the taxpayer upon his return; but the amount so shown on the return shall first be increased by the amounts previously assessed (or collected without assessment) as a deficiency, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; or

* * * * *

(U. S. C., Title 26, SEC. 271.)

SEC. 272. PROCEDURE IN GENERAL.

(a) (1) *Petition to Board of Tax Appeals.*—If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this chapter, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day), the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. No assessment of a deficiency in respect of the tax imposed by this chapter and no distraint or proceeding in

court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such ninety-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final. Notwithstanding the provisions of section 3653 (a) the making of such assessment or the beginning of such proceeding or distraint during the time such prohibition is in force may be enjoined by a proceeding in the proper court. * * *

* * * * *

(g) *Jurisdiction Over Other Taxable Years.*—The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

* * * * *

(U. S. C., Title 26, Sec. 272.)

SEC. 322. REFUNDS AND CREDITS.

* * * * *

(d) *Overpayment Found by Board.*—If the Board finds that there is no deficiency and further finds that the taxpayer has made an overpayment of tax in respect of the taxable year in respect of which the Commissioner determined the deficiency, the Board shall have jurisdiction to determine the amount of such overpayment, and such amount shall, when the decision of the Board has become final, be credited

or refunded to the taxpayer. No such credit or refund shall be made of any portion of the tax unless the Board determines as part of its decision that such portion was paid (1) within three years before the filing of the claim or the filing of the petition, whichever is earlier, or (2) after the mailing of the notice of deficiency.

* * * * *

(U. S. C., Title 26, Sec. 322.)

SEC. 1100. STATUS.

The Board of Tax Appeals (hereinafter referred to as the "Board") shall be continued as an independent agency in the Executive Branch of the Government.

(U. S. C., Title 26, Sec. 1100.)

SEC. 1101. JURISDICTION.

The Board and its divisions shall have such jurisdiction as is conferred on them by chapters 1, 2, 3, and 4 of this title, by Title II and Title III of the Revenue Act of 1926, 44 Stat. 9, or by laws enacted subsequent to February 26, 1926.

(U. S. C., Title 26, Sec. 1101.)

Revenue Act of 1942, c. 619, 56 Stat. 957:

SEC. 504. CHANGE OF NAME OF BOARD OF TAX APPEALS.

(a) *The Tax Court of the United States.*—Effective on the day after the date of enactment of this Act, section 1100 (relating to status of Board of Tax Appeals) is amended by inserting at the end thereof the following new sentence: "The Board shall be known as The Tax Court of the United States and the members thereof shall be known as the presiding judge and the judges of The Tax Court of the United States."

(b) *Powers, Tenure, Etc., Unchanged.*—The jurisdiction, powers, and duties of The Tax Court of the United States, its divisions and its officers and employees, and their appointment, including the designation of its officers, and the immunities, tenure of office, powers, duties, rights, and privileges of the presiding judge and judges of The Tax Court of the United States shall be the same as by existing law provided in the case of the Board of Tax Appeals. * * *

* * * * *

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1942

No. 792

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

v.

GOOCH MILLING & ELEVATOR COMPANY.

**On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.**

## BRIEF FOR GOOCH MILLING & ELEVATOR COMPANY IN OPPOSITION.

F. W. MCREYNOLDS,
and
D. M. KELLEHER,
*Attorneys for Respondent.*

May, 1943.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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### OPINION BELOW.

The opinion of the Circuit Court of Appeals (R. 27-38) is reported in 133 Fed. Rep. (2d) 131.

### JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on January 29, 1943 (R. 27). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

## QUESTION PRESENTED.

Respondent contends: That the question presented is whether the Board of Tax Appeals had jurisdiction to consider and apply the principle of equitable recoupment as a defense to an apparent deficiency for the fiscal year 1936, where the deficiency resulted from the reduction of the taxpayer's 1936 opening inventory identical with the closing inventory for the preceding tax year, thus automatically reducing the liability for 1935 taxes previously paid; and where the inventory reduction decreased the 1935 tax liability by a sum greater than the apparent deficiency for 1936; and where the "equitable reason", known as the right of recoupment, arose out of and inhered in one and the same transaction as the claim for deficiency, thus constituting a complete defense to the claim which would be sustained in a court proceeding. Unlike a demand for refund, the defense of recoupment when supported by the facts is not barred by the limitations statute.

## STATUTES INVOLVED.

The statutes involved are set forth in the appendix *infra*. pp. 13, 14.

## STATEMENT.

The Board of Tax Appeals found that the adjustment of an error in taxpayer's June 30, 1935 inventory, common to successive fiscal tax years 1935 and 1936, warranted the Commissioner's determination of a deficiency for 1936. (R. pp. 13-14) The error adjusted by a change in inventory figures, amounted to $237,104.33. The correction of the error not only resulted in a deficiency for 1936 of $6,663.42, but also, as the Board found, showed there had been "an overassessment for the fiscal year 1935 in the sum of $7,935.58", an amount greater than the 1936 deficiency. This the taxpayer had paid (R. 20 and R. 21-22). As the same inventory which contained the error was the closing inventory for

1935 and the opening inventory for 1936, the adjustment determined upon automatically affected the amount of tax liability for both years, reducing that for 1935, increasing that for 1936.

To arrive at a determination that there was a deficiency for 1936, both the Commissioner and the Board reduced the amount of the June 30, 1935 inventory. Without such reduction there would have been no 1936 deficiency. Respondent presented the issue that as the deficiency for 1936 sprang from the changed inventory figures, which change also automatically reduced the 1935 tax liability, a right of recoupment was available as a defense to the 1936 deficiency claim.

The Revenue Agent's report showed an over-assessment for 1935 of $7,935.59 (R. 20) which was accepted by the Commissioner and is stated in the findings of the Board (R. 14). Although there also were overpayments for tax years preceding 1935, due to inventory errors, they need not be considered, as the overpayment for 1935 alone exceeds the 1936 deficiency. The transaction relied upon to establish the defense of recoupment was the determination by the Commissioner and redetermination by the Board of the reduction of the June 30, 1935 inventory common to the consecutive tax years 1935 and 1936.

Further proceedings before the Board (now The Tax Court of the United States), if no new issues are presented by the Commissioner, as for example that other taxes are owing by Respondent, should present no greater difficulty than would arise if the defense of recoupment was sustained in a court proceeding involving the same claim of liability for a tax deficiency. No question has been raised by Petitioner as to correctness of the tax overpayment found by the Board for 1935.

## ARGUMENT.

### I.

It is contended for Respondent that equitable recoupment is a defense and not, like a claim for refund, an affirmative demand. And that both the Commissioner and the Board should have sustained the defense as one arising out of and inhering in the transaction on which is based a determination of a tax liability for 1936. The facts sustaining the recoupment claim are not in dispute, and appear in substance in the findings of the Board. The facts which establish the defense of recoupment had their origin in the same transaction and subject matter, as the apparent 1936 deficiency claim. The defense of recoupment inhered in the transaction which was the basis for the deficiency claim. There was such direct connection between the tax liability for the consecutive fiscal years 1935 and 1936, in which the same inventory was a basic factor in computing the tax for each of said years, that when the adjustment was made of the June 30, 1935 inventory, the act of reducing the inventory established the defense of recoupment to the resulting apparent deficiency for 1936. This is not to say, as petitioner assumes, that the adjustment merely established an affirmative right to demand a refund for the overpaid 1935 tax, no longer available because of the limitation statute. The facts and circumstances establish a complete defense to the 1936 deficiency tax claim.

The right of equitable recoupment is not a set-off or counterclaim, but an equitable reason which inheres in the transaction out of which the deficiency claim springs and is strictly a defense.

> *Williams* v. *Neely*, 134 Fed. Rep. 1, 5.
> *Crossett Lumber Co. et al.* v. *United States*, 87 Fed. Rep. (2d) 930, 933.
> *Stone* v. *White*, 301 U. S. 532.
> *Bull* v. *United States*, 295 U. S. 247.

Questions of liability for taxes are governed by equitable standards. Without regard to the bar of limitations stat-

utes, defenses inhering in the facts to be weighed in determining whether a tax debt is owing, open the door to the defendant "to show any state of facts which according to those standards would deny the right."

*Stone* v. *White*, 301 U. S. 532, 81 L. Ed. 1265.
*Bull* v. *United States*, 295 U. S. 247, 79 L. Ed. 1421.
*Crossett Lumber Co. et al.* v. *United States*, 87 Fed. Rep. (2d) 930, 933.
*Mills* v. *United States*, 35 Fed. Supp. 535.
*Dixie Margarine Co.* v. *Commissioner*, 115 Fed. Rep. (2d) 445.

While recoupment cannot be made a vehicle to carry an affirmative demand barred by limitations, such as a claim for refund, it is available as a defense to a new tax demand which arises out of the same transaction.

*Dixie Margarine Co.* v. *Commissioner*, 115 Fed. Rep. (2d) 445.
*Crossett Lumber Company et al.* v. *United States*, 87 Fed. Sup. Rep. (2d) 930, 933.
*Bull* v. *United States*, 295 U. S. 247, 79 L. Ed. 1421.

II.

There is as direct connection "between income taxes paid in successive years based upon a single erroneous inventory as there was between the estate tax erroneously determined and income tax correctly determined on the same item in *Bull* v. *United States, supra.*" *Crossett Lumber Co.* v. *United States*, 87 Fed. Rep. (2d) 930, 933.

Had the petitioner paid the 1936 deficiency and sued to recover, it is a fair inference from the position taken by counsel for the Commissioner in the Court of Appeals and here, that the legal sufficiency of the recoupment claim would be conceded. It is our contention that the Commissioner in the first instance should not determine that a deficiency exists if such determination would be reversed by a court called upon to review the finding and decision of the Commissioner. It is not conceivable that Congress intended

the officials charged with administrative duties should make determinations which, when challenged in a court, would be subject to reversal because contrary to the legal rights of the taxpayer.

The Board of Tax Appeals was created for the express purpose of enabling the taxpayer to obtain by an appeal to the Board, correction of the Commissioner's errors, and thus make it unnecessary to pay the tax and sue the Collector for the amount erroneously exacted.

"The sections creating the Board and investing it with power can leave no doubt that they were intended to confer upon it appellate powers which are judicial in character." *Blair* v. *Osterlein Machine Co.*, 277 U. S. 551.

"The provisions of law concerning the Board show that it is, when appealed to by a taxpayer, to have full and unimpeded authority to redetermine the taxes for the tax year, and its decision is to be final, subject to the review allowed before the Circuit Court of Appeals. The taxpayer who elects to invoke the jurisdiction of the Board accepts this consequence." *Cook* v. *United States*, 108 Fed. (2d) 804, 806.

Section 284(d), Revenue Act of 1926, 44 Stat. 66, providing that after a petition is filed with the Board in response to a deficiency notice, "No suit by the taxpayer for the recovery of any part of such tax shall be instituted in any court * * *", is therefore intended to make the Board the sole arbiter of the rights of the parties once an appeal is taken. To hold that a taxpayer taking such an appeal to establish his defense of recoupment unwittingly waives the defense by his appeal attributes to Congress a purpose which could never have been intended.

## III.

Section 272 (g), Revenue Act of 1934, c. 277, 48 Stat. 680, requires that the Board "in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency * * *."

Respondent contends that the affirmative duty imposed by the quoted words required the Board in redetermining the claim of a 1936 deficiency to give effect to the facts disclosing a defense to the claim. And that the taxpayer's right to the benefit of the defense is not nullified by the further words in the nature of a proviso, "but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid." That the power of the Board to investigate and consider the facts with respect to June 30, 1935 inventory included the power to determine the effect of a reduction of the inventory where the reduction itself resulted in a defense to the deficiency. The 1936 deficiency could not be determined or redetermined without disclosing the existence of the defense. Substance and not form is the controlling principle, and the determination of a defense to the deficiency claim would not violate the letter of the statute.

In this case the June 30, 1935 inventory was a fact related in the same way to the taxes for both the year 1935 and 1936. The Board did consider that fact and the effect of the reduction in the amount the inventory, from which it appeared and was so determined that the correction of the inventory proved that the Treasury had in its hands as a result of the overassessment for 1935 and payment by the taxpayer, an amount greater than the apparent 1936 deficiency resulting from the change in the figures of the inventory. If these facts constituted a good legal defense to the apparent deficiency, the Board had the power to so determine. It had jurisdiction in redetermining the 1936 deficiency to declare there was no deficiency.

Jurisdiction under the statute was vested in the Board to consider the facts "with relation to the taxes" for 1935, if such consideration had a bearing upon the performance by the Board of its duty "correctly to redetermine" the amount of the 1936 deficiency. In the exercise of this jurisdiction, the Board did consider these facts "with relation to the taxes" for 1935. The identical inventory which was the taxpayer's closing inventory for 1935 and opening inven-

tory for 1936 was one of the facts considered. The facts and Board's findings establish the existence of an equitable reason which inhered in the same transaction out of which the apparent deficiency claim springs, constituting a defense to the 1936 deficiency. The claim for a 1936 deficiency and the defense to the claim called the right of recoupment, have their origin in the same transaction—the erroneous inventory. The deficiency claim itself sprang from and inhered in the inventory adjustment which, when adjusted, established the taxpayer's right of recoupment.

When the Commissioner determined, and the Board redetermined, the June 30, 1935 inventory, the consequences which followed should not be viewed as split in two unrelated parts, and given effect as creating a 1936 tax demand or debt and ignored as establishing a legal defense to the same debt. The power conferred upon the Board to "consider facts with relation to the taxes for other taxable years" must mean the power to consider the effect of such facts as a defense to an apparent deficiency for the year under investigation. Unless such facts had some effect upon the taxes for the year under investigation, their "consideration" would be futile. If given any effect, they should be given every effect the principles of law recognize. If the facts reduce the deficiency or reveal a full legal defense, that result is within the power of the Board to find and declare. As the opinion of the Court of Appeals states, the Board may not order a refund, and no determination that a refund be ordered was sought. It was only necessary for the Board to determine whether the apparent deficiency and the legal right to recoupment had a common origin or source, which in this case was apparent on the face of the transaction.

## IV.

It is the theory of the Board and the Petitioner that a taxpayer having a good legal defense to an apparent deficiency under the principle of recoupment, and who files his petition

for a redetermination by the Board of Tax Appeals in order that his defense be upheld, paradoxically, thereby waives that defense. The taxpayer's right to the benefit of his defense, available in a court, is sought to be distinguished from the same right when asserted in a proceeding before the Board. To sustain this contention, it is assumed that the right of recoupment is not in fact a defense, but an affirmitive demand, if recoupment is asked in a proceeding before the Board. Facts which in a similar controversy in a court establish a defense to the deficiency claim are thus to be regarded as of no effect except to show the existence of a barred claim for refund. To justify this position it is argued that recoupment cannot be considered if the taxpayer files with the Board a petition for redetermination, instead of proceeding as was required before the Board was created, notwithstanding the decision to the contrary in *Dixie Margarine Co.* v. *Commissioner*, 115 Fed. Rep. (2d) 445, 447. In that case upon a petition to review the Board's decision involving the application of the principle of recoupment it was held: "The Board had no occasion to consider whether the statute of limitations affected the availability of petitioner's claim in recoupment. We think it did not."

The petition for the writ cites certain decisions to sustain the contention that "Congress has provided, and this and other courts have * * * long considered that the Board has no power to apply the doctrine of recoupment * * *". *United States ex rel. Girard T. Co.* v. *Helvering*, 301 U. S. 540, is cited. That was a mandamus action to command a refund of a tax in which the jurisdiction of the Board to adjudicate the deficiency there determined was sustained, but such determination was held not to support an action in mandamus to compel a refund, viz: "The Board is without authority to order a refund or a credit, although its decision is res judicata as to the questions involved in the computation and assessment of taxes for which a deficiency is claimed."

Among the reasons for refusing mandamus, the Court in that case said that other taxes may be owing by the

taxpayer, or there may be other reasons why the taxpayer is not equitably entitled to be paid the amount of the refund as computed and determined by the Board. It is open to the Commissioner here to present that issue on the remand for further proceedings, if any facts warrant such issue in this action. The possibility of such issue should not prevent the Board from applying the principle of recoupment to the 1936 deficiency claim.

*Commissioner of Internal Revenue* v. *Forest Glen Creamery Co.*, 98 Fed. Rep. (2d) 968, also cited, turned upon the sufficiency of the Commissioner's deficiency notice to the taxpayer. Reversing the decision of the Board and holding that the deficiency notice was sufficient, the Court merely prefaced its decision on that point with a quotation from the Revenue Act of 1926, Sec. 274 (g), 44 Stat. 55, as follows: "When the Commissioner of Internal Revenue has determined a deficiency against a taxpayer for a taxable year the Board of Tax Appeals has no jurisdiction 'to determine whether or not the tax for any other taxable year has been overpaid or underpaid'."

There is no opinion of the Court of Appeals in *Greenleaf Textile Corp.* v. *Commissioner*, 65 Fed. (2d) 1017, also cited. The grounds for the affirmance of the decision of the Board in that case do not appear in the reported decision.

The decisions of the Board are reviewable by the Circuit Courts of Appeals, which are by the statute given power "if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board." Revenue Act of 1926, Sec. 1003, 44 Stat. 110. Thus the intention of Congress is clear that the decisions of the Board are subject to reversal if not "in accordance with law". A defense which a court would sustain should be sustained by the Board.

The right of recoupment is as much a legal defense when established by the facts as any other defense, and is not barred by the limitations statutes which bar a claim for refund. As the Court in *Stone* v. *White*, 301 U. S. 532, said:

"The statutory bar to the right of action for the collection of the tax does not prevent reliance upon a defense which is not a set-off or a counterclaim, but is an equitable reason, growing out of the circumstances of the erroneous payment, why petitioners ought not to recover."

"If there is a deficiency assessment, the jurisdiction of the Board extends to the whole controversy, to the end that it may determine or redetermine the correct amount of the tax." *Houston Street Corp.* v. *Commissioner*, 84 Fed. Rep. (2d) 821, 822.

The proceeding for redetermination by the Board "is in nature similar to and is of equal formality with a suit to recover a tax paid." *Bishoff* v. *Commissioner of Internal Revenue*, 27 Fed. Rep. (2d) 91, 93

When the Board's jurisdiction is properly invoked, it "Has power to revise legal errors of the Commissioner whether they be for or against the taxpayer." *Champlin* v. *Commissioner*, 78 Fed. Rep. (2d) 905, 907.

In view of the purpose for which the Board is established, "it has equal power to do full justice to the parties" that a court would have. *Helvering* v. *Edison Securities Corp.*, 78 Fed. Rep. (2d) 85, 91.

The Board "is an executive or administrative Board, exercising powers judicial in character." *Garden City Feeder Co.* v. *Commissioner*, 75 Fed. Rep. (2d) 804, 806.

"If there is a deficiency assessment, the jurisdiction of the Board extends to the whole controversy, to the end that it may determine or redetermine the correct amount of the tax." *Peerless Woolen Mills* v. *Rose*, 28 Fed. Rep. (2d) 661, 662.

In this case the Board erroneously refused to sustain the defense of recoupment, and, though citing among other cases, *Dixie Margarine Co.* v. *Commissioner*, 115 Fed. Rep. (2d) 445, which reversed the Board for not applying the principle of recoupment, said:

> "None of the above court cases hold that the Board has jurisdiction to consider the doctrine of equitable

> recoupment with respect to statutory deficiencies. The Board itself has held that it has no authority under the limited jurisdiction conferred upon it to apply the principles of recoupment." (R. 14)

The Court of Appeals held that such limitation upon the Board's powers was unwarranted.

The fear of Petitioner that the statutes limiting the jurisdiction of the Board are being destroyed is groundless. The Respondent is merely asking that in their interpretation well established equitable principles be applied to prevent the exaction of a debt it does not owe, and which is barred from refund if such exaction is permitted.

## CONCLUSION.

The decision of the Court below was correct; the petition raises no question entitling Petitioner to the review asked.

Respectfully submitted,

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and
D. M. KELLEHER,
*Attorneys for Respondent.*

May, 1943.

## APPENDIX.

Revenue Act of 1934, c. 277, 48 Stat. 680, provides:

SEC. 272. PROCEDURE IN GENERAL.

(a)(1) Petition to Board of Tax Appeals.—If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this chapter, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day), the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. * * *

* * * * * * * * * * *

(b) Collection of Deficiency Found by Board.—If the taxpayer files a petition with the Board, the entire amount redetermined as the deficiency by the decision of the Board which has become final shall be assessed and shall be paid upon notice and demand from the collector. No part of the amount determined as a deficiency by the Commissioner but disallowed as such by the decision of the Board which has become final shall be assessed or be collected by distraint or by proceeding in court with or without assessment.

* * * * * * * * * * *

(e) Increase of Deficiency After Notice Mailed.—The Board shall have jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount of the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any penalty, additional amount or addition to the tax should be assessed—if claim therefor is asserted by the Commissioner at or before the hearing or a rehearing.

* * * * * * * * * * *

(g) Jurisdiction Over Other Taxable Years.—The Board in redetermining a deficiency in respect of any taxable year

shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

Revenue Act of 1926, c. 27, Sec. 1003 (a) and (b), 44 Stat. 110, provides:

Courts of Review.—(a) In General. The Circuit Courts of Appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board, * * *

* * * * * * * * * * *

(c) Powers—(1) To affirm, modify, or reverse. Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.

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No. 53.

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1943.

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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

v.

GOOCH MILLING & ELEVATOR COMPANY, *Respondent.*

---

**On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.**

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## BRIEF FOR RESPONDENT.

---

F. W. MCREYNOLDS,
and
D. M. KELLEHER,
*Attorneys for Respondent.*

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GOOCH MILLING & ELEVATOR COMPANY, *Respondent.*

---

**On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.**

---

## BRIEF FOR RESPONDENT.

---

### OPINION BELOW.

The opinion of the Circuit Court of Appeals (R. 27-38) is reported in 133 Fed. Rep. (2d) 131.

### JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on January 29, 1943 (R. 21). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

## QUESTION PRESENTED.

The question presented is whether the Board of Tax Appeals in redetermining a deficiency for 1936 had jurisdiction to give effect to a defense to the 1936 deficiency based on the doctrine of equitable recoupment. An outline of the facts is as follows: Because of an error in the amount, the Commissioner adjusted, by a reduction, taxpayer's June 30th, 1935 inventory, resulting in an increase of tax for the fiscal year 1936. The inventory was common to successive tax years, being the closing inventory for the fiscal year 1935 and the opening inventory for 1936. The adjustment reduced the tax liability for 1935 (which taxes had been paid), by an amount greater than the 1936 deficiency. As determined by the Commissioner, and found by the Board on redetermination, the facts established the defense of recoupment which a court would sustain. The question presented, therefore, is whether upon a redetermination by the Board its jurisdiction is so restricted that the same effect could not be given to a defense to the 1936 deficiency that a court would give.

## STATUTES INVOLVED.

The statutes involved are set forthin the appendix infra, pp. 20, 21.

## STATEMENT.

The Board of Tax Appeals reviewed the Commissioner's determination of a deficiency for the fiscal year 1936, and held it had "no jurisdiction to consider the defense raised by the petitioner" (R. 11). The Commissioner determined that there was an error in the taxpayer's June 30th, 1935 inventory—the closing inventory for the fiscal year 1935 and the opening inventory for 1936. This inventory, common to successive tax years, the Commissioner adjusted to conform to the Revenue Agent's report, by subtracting

from the taxpayer's inventory the amount of $237,104.33. This inventory reduction resulted in a deficiency for 1936 of $6,663.42, after allowance for certain payments made by the taxpayer. The change in inventory figures according to the Revenue Agent's report and as the Board found, also resulted in "an over-assessment for the fiscal year 1935 of $7,935.58," (R. 11) an amount greater than the 1936 deficiency as determined. The 1935 tax computed upon the basis of the erroneous June 30th, 1935 inventory had been paid. (R. 16) When the inventory error was discovered and corrected, a claim for refund was barred by limitations statutes. The inventory change both reduced the tax liability for 1935 and increased it for 1936. Except for the reduction in the June 30th, 1935 inventory, there would be no deficiency.

The taxpayer in an amendment to its petition lodged with the Board pleaded the right of recoupment as a defense to the claim of a deficiency for 1936. Its motion for leave to amend (R. 9) was denied on the sole ground that the Board had no jurisdiction in redetermining the deficiency, to sustain a defense to the 1936 deficiency based on the right of recoupment. (R. 11)

The Revenue Agent's report, accepted by the Commissioner as the basis for his determination, showed an overassessment for 1935 of $7,935.59 (R. 17), and this fact appears in the findings of the Board. (R. 11) Although there were overpayments exceeding $8,000 for tax years 1928 to 1934, also due to inventory errors, such overpayments need not be considered in order to support the claim of recoupment, because the overpayment for 1935 alone exceeds the 1936 deficiency. (R. 11)

The principal facts are set forth in the findings of the Board as follows:

1. "Petitioner's balance sheet for the taxable year shows an opening inventory of $361,701.88, and a closing inventory of $345,017.43. The deficiency letter shows that respondent

reduced petitioner's opening inventory at July 1, 1935 by the following adjustment, 'inventory adjustment, June 30th, 1935, $237,104.33.' The deficiency herein results primarily from this adjustment of petitioner's inventory." (R. 11)

2. "Following the death of petitioner's president on June 11, 1938, an audit of petitioner's books revealed that all inventories as far back as 1928 were erroneous. The reduced inventory was first computed by petitioner's accountants and was accepted by respondent as the basis for the present deficiencies." (R. 11)

3. "Based upon corrected inventories the petitioner had over-paid its income taxes for all the years 1928 to 1934, inclusive, in a net sum in excess of $8,000. The revenue agent's report for the fiscal year 1935 shows an overassessment for the fiscal year 1935 in the sum of $7,935.58, which amount is not subject to refund because barred by the Statute of limitations." (R. 11)

On a petition to review the decision of the Board, the Court of Appeals for the Eighth Circuit reversed the Board (now The Tax Court of the United States), 133 Fed. (2d) 131.

## SUMMARY OF ARGUMENT.

1. Petitioner's argument, summarized on pages five to seven of the brief, contends that the Board has "no general jurisdiction" and is not an agency empowered "to settle generally the tax account between an individual and the Government"; that its sole function is to review "certain restricted classes of proposed assessments", leading to the conclusion that although the facts considered in redetermining the deficiency show a defense a court would uphold, the taxpayer deprives himself of his right to this defense on appeal to the Board, because "the Board is without power to apply any overpayments for prior years against the liability for the fiscal year 1936". No distinction is made in the argument for petitioner between cases where

the facts support a defense to the deficiency under investigation based on the right of recoupment, and cases where the facts would support only an affirmative demand for refund.

2. A fair construction of Section 274 (g) of the 1926 Act (Section 272 (g) of the Internal Revenue Code) is that in following the statutory mandate to consider the tax liability for "other taxable years", the facts found on investigation are to be given such effect as "may be necessary to correctly redetermine" the deficiency for the year under investigation, and when the facts establish a full defense to a deficiency determined by the Commissioner, and no affirmative order for a refund or credit is necessary, the Board has power to sustain such defense in the exercise of it's jurisdiction to redetermine the deficiency.

3. The Board has full power to redetermine the deficiency claim or demand determined in the first instance by the Commissioner. The power of the Board in such redetermination is not more restricted than is the power of the Commissioner in his determination. That the Commissioner should sustain a defense based on the right of recoupment is proved by the fact that in a court proceeding his denial of such defense will be held erroneous.

4. A taxpayer who has a good defense to a claimed deficiency is entitled to have that defense recognized in the first instance by the Commissioner. The Commissioner should not deny the defense in the expectation that the jurisdiction of the reviewing tribunal will be narrower than his own. Obviously it is the Commissioner's duty to decide according to the legal rights of the taxpayer, and the presumption should be indulged that a tribunal created to redetermine the deficiency has jurisdiction to do what the Commissioner should have done.

5. In weighing the facts, the Commissioner must consider and give due weight to any legal defense. The right of re-

coupment is such defense. Concededly the defense is not lost to the taxpayer by the Commissioner's refusal to recognize it. It is merely contended that the Commissioner's error can be corrected only if the taxpayer pays the erroneously determined tax and sues in court to recover. The Board of Tax Appeals was created to assure the taxpayer correction of the Commissioner's errors by appeal to the Board before paying the tax, and its jurisdiction upon redetermination was intended to be co-extensive with that of the Commissioner.

## ARGUMENT.

Respondent contends that the right of equitable recoupment is available to the taxpayer in redetermination proceedings before the Board as a defense to the demand of a deficiency for 1936. That it was the duty of the Board to consider the "facts with relation to the taxes for other taxable years" in order to redetermine the 1936 deficiency.

The facts sustaining the right to recoupment are not in dispute, and are in substance contained in the findings of the Board. The facts which establish the defense of recoupment originate in the adjustment of the error in the June 30th, 1935 inventory, the same transaction upon which is based the determination of a 1936 deficiency. There was such direct connection between the tax liabilty for the consecutive fiscal years 1935 and 1936, in which the same inventory was a basic factor for computation of the tax liability for each of said years, that when the inventory reduction was determined upon by subtraction of $237,104.33 from the inventory figures, the 1935 tax liability was reduced by an amount which the facts and findings show exceeded the 1936 deficiency resulting from the inventory reduction. These facts called for the application of the doctrine of recoupment by way of a defense to the 1936 deficiency and should not, as petitioner's brief assumes, be limited in effect to supporting an affirmative right to demand a refund for the overpaid 1935 tax, no longer available because

of the limitation statute. The facts and circumstances established *a complete defense* to the 1936 deficiency tax claim.

The right of equitable recoupment is not a set-off or counterclaim, but an equitable reason which inheres in the transaction out of which the deficiency claim springs and is strictly a defense.

*Williams* v. *Neely*, 134 Fed. Rep. 1, 5.
*Crossett Lumber Co. et al.* v. *United States*, 87 Fed. Rep. (2d) 930, 933.
*Stone* v. *White*, 301 U. S. 532.
*Bull* v. *United States*, 295 U. S. 247.

Determination of tax liability where the right of recoupment is in issue is governed by equitable standards. Without regard to the bar of limitations statutes, defenses which inhere in the same facts upon which liability is predicated, open the door to the taxpayer "to show any state of facts which according to those standards would deny the right."

*Stone* v. *White*, 301 U. S. 532, 81 L. Ed. 1265.
*Bull* v. *United States*, 295 U. S. 247, 79 L. Ed. 1421.
*Crossett Lumber Co. et al.* v. *United States*, 87 Fed. Rep. (2d) 930, 933.
*Mills* v. *United States*, 35 Fed. Supp. 535.
*Dixie Margarine Co.* v. *Commissioner*, 115 Fed. Rep. (2d) 445.

The doctrine of recoupment is not available to support an affirmative demand barred by limitation, such as a claim for refund, but is available as a defense to a new tax demand which arises out of the same transaction.

*Dixie Margarine Co.* v. *Commissioner*, 115 Fed Rep. (2d) 445.
*Crossett Lumber Company et al.* v. *United States*, 87 Fed. Rep. (2d) 930, 933.
*Bull* v. *United States*, 295 U. S. 247, 79 L. Ed. 1421.

There is as direct connection "between income taxes paid in successive years based upon a single erroneous inventory

as there was between the estate tax erroneously determined and income tax correctly determined on the same item in *Bull* v. *United States, supra.*" *Crossett Lumber Co.* v. *United States*, 87 Fed. Rep. (2d) 930, 933.

Had the petitioner paid the 1936 deficiency and sued to recover, it is a fair inference from the position taken by counsel for the Commissioner in the Court of Appeals and here, that the legal sufficiency of the defense by way of recoupment would be conceded. It is our contention that the Commissioner in the first instance should not determine that a deficiency exists if such determination would be reversed by a court called upon to review the finding and decision of the Commissioner; and that the Board's power on redetermination is co-extensive. It is not conceivable that the Congress intended the officials charged with administrative duties should make determinations which, when challenged in a court, would be reversed because contrary to the legal rights of the taxpayer. It is only when the facts show no defense to the deficiency demand, but are only sufficient to support an affirmative demand for a refund barred by limitations, that the Commissioner's determination is governed by a rule of law similar to the rule invoked in the Petitioner's brief.

Under Section 3774 of the Internal Revenue Code, a refund is erroneous if a claim for refund is not filed within the period of limitations. But, as was recognized in *McEachern* v. *Rose*, 203 U. S. 56, Sections 3774 and 3775 do not apply "in the circumstances disclosed in *Stone* v. *White*, 301 U. S. 532." It follows that when the facts warrant the application of the doctrine of recoupment, as is true here, the determination must be made with due regard to the nature of the right of recoupment. This is because a taxpayer entitled to recoupment is entitled to his defense to the demand or claim for a deficiency and need not resort to a claim for refund. The defense is available where, as here, it inheres, and has its origin in the same transaction which gives rise to the demand, and springs from the very sub-

ject matter upon which the deficiency claim is based. The fact that a refund would be erroneous because barred by limitations, is not controlling. It is of the essence of the right to recoupment that it is in the nature of a defense to a claim. Statutes designed to cut off stale or barred demands do not deprive a taxpayer, any more than any other litigant, of his defenses.

The right of recoupment, when established by the facts, is as much a legal defense as any other defense, and is not barred by the limitations statutes which bar a claim for refund. As the court in *Stone* v. *White*, 301 U. S. 552, said: "The statutory bar to the right of action for the collection of the tax does not prevent reliance upon a defense which is not a set-off or a counterclaim, but is an equitable reason, growing out of the circumstances of the erroneous payment, why petitioners ought not to recover."

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The argument for Petitioner that the Board lacks jurisdiction to give effect to facts constituting a good defense to the 1936 deficiency based upon taxpayer's right of recoupment, must mean that upon redetermination by the Board its power is more restricted than that of the Commissioner. The Commissioner's determination of a deficiency would then be right or wrong, according to whether the taxpayer appealed for redetermination by the Board; or paid the tax, asked a refund, and sued in court. The Board of Tax Appeals was created for the express purpose of assuring the taxpayer a redetermination by the Board before assessment of the tax. The procedure was devised as a measure of relief to taxpayers from burdens imposed by the earlier exclusive method of reviewing the Commissioner's determination by action in court after assessment and payment. A partial redetermination by the Board, excluding the issue that there is no deficiency owing because the facts show a defense to an assessment in any amount, would not accomplish the purpose for which the Board was established.

The argument that the defense of recoupment cannot be considered as within the Board's jurisdiction is contrary to the decision in *Dixie Margarine Co.* v. *Commissioner*, 115 Fed. Rep. (2d) 445, 447. In that case upon a petition to review the Board's decision involving the application of the principle of recoupment, it was held: "The Board had no occasion to consider whether the statute of limitations affected the availability of petitioner's claim in recoupment. We think it did not."

Petitioner's brief reviews the history of the administration of tax laws before the creation of the Board of Tax Appeals, and in effect argues that the Board's jurisdiction should be narrowly restricted in redetermining deficiencies, because originally an error of the Commissioner could not be reviewed except by a court.

Judicial pronouncements, however, are to the effect that the jurisdiction of the Board to redetermine tax liability is co-extensive with that of the Commissioner, as the following citations show:

"If there is a deficiency assessment, the jurisdiction of the Board extends to the whole controversy, to the end that if may determine or redetermine the correct amount of the tax." *Houston Street Corp.* v. *Commissioner*, 84 Fed. Rep. (2d) 821, 822.

The proceeding for redetermination by the Board "is in nature similar to, and is of equal formality with a suit to recover a tax paid." *Bishoff* v. *Commissioner of Internal Revenue*, 27 Fed. Rep. (2d) 91, 93.

In view of the purpose for which the Board is established, "it has equal power to do full justice to the parties" that a court would have. *Helvering* v. *Edison Securities Corp.*, 78 Fed. Rep. (2d) 85, 91.

"If there is a deficiency assessment, the jurisdiction of the Board extends to the whole controversy, to the end that it may determine or redetermine the correct amount of the tax." *Peerless Woolen Mills* v. *Rose*, 28 Fed. Rep. (2d) 661, 662.

While the Board is an independent agency in the executive branch of the Government, the appellate powers conferred upon the Board are judicial in character. *Blair* v. *Osterlein Machine Company*, 275 U. S. 220. *Champlin* v. *Commissioner*, 78 Fed. Rep. (2d) 905, 907 (C. C. A. 10th) states that, "The Board, when its jurisdiction is properly invoked, has power to revise legal errors of the Commissioner whether they be for or against the taxpayer." The jurisdiction conferred to redetermine the deficiency is broad enough to empower the Board to sustain a defense to the deficiency without a special grant of jurisdiction enumerating all possible defenses that the facts in any case appealed may support.

And, on petition to review the Board's decisions, the Courts are by statute required to determine whether the "decision of the Board is in accordance with law." Internal Revenue Code Section 1141 (c) (1). A redetermination which denies a defense that would prevail in a court clearly is not "in accordance with law."

The doctrine of recoupment is applicable to tax controversies. It is immaterial how the parties are arrayed in the proceeding, as a fact-supported defense of recoupment operates alike to defeat claims of the Government and the taxpayer. The defense is not barred so long as the main action is timely. The authorities are unanimous that because the right of recoupment arises out of the same facts as the claim, demand, or cause of action itself, it is a good defense.

The Board had general jurisdiction to redetermine the 1936 deficiency and, if the facts warranted, to determine there was no deficiency. In the redetermination proceeding it appeared that the change or adjustment of the June 30th, 1935 inventory was necessary to support the deficiency, but if the doctrine of recoupment applied, the same facts supported a defense to the deficiency. If the Board must disregard a defense based on the doctrine of recoupment (which a court would sustain), the procedure prescribed

by law would surely mislead the taxpayer. The law requires a notice to the taxpayer of his right to redetermination by the Board before a tax is assessed. Upon appealing for a redetermination in compliance with the notice, he is barred from any action in court other than a court review of the Board's decision. Internal Revenue Code Section 322 (c). *Cook* v. *United States*, 108 Fed. (2d) 804, 806 (C. C. A. 2nd).

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Jurisdiction under the statute was vested in the Board to consider the facts "with relation to the taxes" for 1935, if such consideration had a bearing upon the performance by the Board of its duty "correctly to redetermine" the amount of the 1936 deficiency. In the exercise of this jurisdiction, the Board did consider these facts "with relation to the taxes" for 1935. Before the 1936 tax could be computed at all, it was absolutely necessary to determine the closing inventoryq for 1935; there was no other way of ascertaining the opening inventory for 1936.. The facts and findings establish the existence of the equitable reason which inheres in the transaction out of which the deficiency claim springs, constituting a defense to the 1936 deficiency. The claim for a 1936 deficiency and the defense to the claim called the right of recoupment, have their origin in the same transaction—the erroneous inventory.

When the Commissioner determined, and the Board redetermined, the June 30th, 1935 inventory, the consequences which followed should not be viewed as split in two unrelated parts, and given effect as creating a 1936 tax demand or debt, and ignored as establishing a legal defense to the same debt. The power conferred upon the Board to "consider facts with relation to the taxes for other taxable years" must mean the power to consider the effects of such facts as a defense to an apparent deficiency for the year under investigation. Unless such facts had some effect upon the taxes for the year under investigation, their "consideration" would be futile. If given any effect, they should be given every effect the rules of law recognize. If

the facts reduce the deficiency or reveal a full legal defense, that result is within the power of the Board to find and declare. As the opinion of the Court of Appeals states, the Board may not order a refund, and no redetermination requiring such order was asked. It was only necessary for the Board to determine whether the apparent deficiency and the facts supporting the right to recoupment had a common origin or source, which in this case was apparent on the face of the transaction.

Petitioner's argument that although the Board is required to consider "such facts with relation to the taxes of other taxable years," necessary for a correct redetermination (Section 272 (g) of the Internal Revenue Code) the proviso, "but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid" withdraws from the Board power to correct the errors of the Commissioner in the proceeding under review.

The enacting clause of this statute confers jurisdiction upon the Board to redetermine the issue and the facts considered by the Commissioner, and specifically to consider such facts with reference to the taxes for other taxable years "as may be necessary correctly to redetermine the amount of such deficiency."

The reason for the proviso, we submit, is to limit the effect of "such facts" to the deficiency for the year involved in the appeal. The Board could not order a refund. If, however, the Commissioner should have determined that the facts established a defense to the deficiency, the Board could correct the error in its redetermination.

The right of recoupment, limited as it is to the transaction out of which the determination of a deficiency arises, and therefore a defense inhering in the Government's claim for the deficiency tax, is an available defense which must either prevail or be rejected in redetermining the deficiency. If the right to equitable recoupment could be asserted only as a cross demand, or by way of claim for refund, the con-

tention as to the application of the proviso to the facts would be supported by a more persuasive argument than the one urged. The proviso must be strictly construed and not only must the facts be within the letter of the proviso, but within its reason.

The body of the act contemplates a redetermination of the 1936 tax liability by the Board. The enacting clause is general. Under settled rules of construction, the proviso must be construed strictly. No case is taken out of the enacting clause unless it falls clearly within the proviso. A proviso carves special exceptions only out of the general enacting clause. *United States* v. *Dickson*, 15 Peters (40 U. S.) 141; *Ryan* v. *Carter*, 93 U. S. 78.

The Petitioner's argument seeks by construction to limit the enacting clause to situations such as a redetermination where there are net losses carried over to the succeeding tax year, consideration of invested capital and questions pertaining to deductions for depreciation. The words of the Act, however, do not so limit the Board in its investigation of the facts preliminary to the redetermination of the taxpayer's liability for the deficiency. The mandate to the Board to consider the facts with relation to the taxes of other taxable years is in general terms.

A careful reading of the section, we submit, indicates that the Board has power to make any redetermination as to the 1936 deficiency which the facts warrant, and to correct any error that inheres in the Commissioner's determination. For that purpose it is the duty of the Board to consider all the facts pertaining to the taxes for other taxable years. But, its "determination" is a determination of the 1936 deficiency. A determination, as the term is used in the Revenue Acts, is an administrative act which, as the Court said in *Bull* v. *United States*, 295 U. S. 274, 79 L. Ed. 1421, is the equivalent of a judgment. This judgment the Board enters only as it concerns the year for which the Commission has determined a deficiency.

The narrow question stated as the question to be decided in *McEachern* v. *Rose*, 302 U. S. 56, was whether the overpayments "are so related" to the tax that should have been, but was not, assessed, as to preclude recovery. Here they are so related. This, we submit, is the test, and the McEachern case, we submit, is not authority to the contrary.

Statutes of the State of New York and of Wisconsin, which in terms come closer to cutting off a right of recoupment than the statute under consideration, have been construed as not destroying the defense of recoupment.

The Wisconsin statute is Wisc. Stat. Section 330.27, which provides that "a cause of action upon which an action cannot be maintained, as prescribed in this chapter, cannot be effectually interposed as a defense, counterclaim or set-off."

A similar statute of the State of New York (omitting the word "set-off") has also been construed as not depriving a defendant of his defense of recoupment. Notwithstanding the statute, a defendant may show any facts which reduce or defeat the plaintiff's claim including the defense of recoupment.

> *Peterson* v. *Feyereisen*, 203 Wisc. 294, 73 A. L. R. 571, 573, followed in *Webb* v. *American Surety Company*, 88 Fed. Rep. (2d) 171, 174, and in *Dixie Margarine Co.* v. *Commissioner*, 115 Fed. Rep. 445, 448, where the same question was involved as in the instant case.
>
> *Kelly Asphalt Block Co.* v. *Brooklyn Alcatraz Asphalt Co.*, 190 App. Div. 750, 180 N. Y. Supp. 805.
>
> *Marsh* v. *Richer*, 68 Misc. Rep. 587, 125 N. Y. 245.

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The basis of the doctrine of recoupment is that principle of natural justice which forbids the enforcement of demand to which there is a defense growing out of the same trans-

action. A demand arising from the correction of an error in a case where due to the same error, the creditor has previously been overpaid, arises out of the same transaction.

" 'Transaction' is a word of flexible meaning. It may comprehend a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship." *Moore* v. *New York Cotton Exchange*, 270 U. S. 593, 45 A. L. R. 1370, 1378.

It is open to the taxpayer to show "any state of facts" which identifies the defense as springing from the same source as the demand. When such facts appear, the defense is not barred by limitations if the creditor's demand is timely. The defense of recoupment does not succeed by revival of a stale claim in the nature of a cross-demand, but because the demand itself is unjust. In this case the facts were before the Commissioner and the Board. The Commissioner accepted the report of the Revenue Agent showing the overassessment for 1935 of $7,935.58, as set out in Exhibit 4 received in evidence (R. 15), and which shows "an over-assessment of income tax for the year ending June 30th, 1935 of $7,935.58." (R. 16)

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Petitioner argues that the Board has no equity powers, and for that reason in redetermining a deficiency could not give effect to a right of recoupment; also that the remedy by way of recoupment is not available until both the amount of the creditor's claim and the sum asked to be recouped are established in some prior proceeding. We contend that the principle of recoupment is of common law rather than of equity origin, and that it is frequently applied where the amount of the demand and the amount asked by way of recoupment are for the first time presented for determination in the proceeding in which the defense of recoupment prevails.

"Recoupment, however, is in the nature of a common-law defense, and differs from set-off and counterclaim mainly in that the claim upon which it is based must grow out of the very same transaction which furnishes the plaintiff's cause of action, and, being in the nature of a claim to reduce the amount demanded, recoupment can be had only to an extent sufficient to satisfy the plaintiff's claim, * * *." (Annotation to *United States* v. *National City Bank*, 106 A. L. R. 1242)

"While the remedy is of common-law origin, it is an innovation on the strict rules of the common law; it may be employed in equity, and, in some states, it is the subject of code or statutory provisions. The right to recoup has not been abolished by the code provisions. Even in states wherein the codes do not specifically mention recoupment as a form of pleading, the right to recoup still exists, * * *." 57 C. J. 358.

In *Edgemoor Iron Co.* v. *Brown Hoisting Machine Co.*, 22 Del. 10, it is said:

> "The doctrine of recoupment was recognized and allowed at common law, and was and is applied to actions whether founded in contract or in tort, but it is limited as a defense to defeating the plaintiff's action, in whole or in part."

Cooley, J. in *Chandler* v. *Childs*, 42 Mich. 128, discussing the application of the doctrine of recoupment where the respective claims of the plaintiff and defendant were both unliquidated and the amounts could only be fixed in the process of determining the issues, said:

> "It is always objectionable to make a substantial defense depend upon the form of action the plaintiff may have chosen to adopt, and we agree with the Supreme Court of Massachusetts that recoupment is as applicable in cases of tort as in cases of contract. Carey v. Guillon, 105 Mass. 18."

In *McHardy* v. *Wadsworth*, 8 Mich. 349, 353, Judge Christiancy said:

> "A defense, by way of recoupment, denies the validity of the plaintiff's cause of action to so large an amount as he claims. It is not an independent cross-claim, like a separate and distinct debt or item of account due from the plaintiff, but is confined to matters arising out of, or connected with, the contract or transaction which forms the basis of the plaintiff's action."

The Court of Appeals for the Sixth Circuit in *Skud* v. *Tillinghast*, 195 Fed. Rep. 1, 8, answering a contention that the remedy by way of recoupment was in equity, said:

> "It was held below that Skud's remedy is in equity; but that is not his only remedy. He may have any damages he has suffered through loss of the stock, applied in reduction of the indebtedness due upon his promise. If such a defense is not within the doctrine of set-off as it exists under the statute and the practice of Michigan, it seems clear that it is within the doctrine of recoupment under the statute of the state and the practice in that behalf."
>
> "Set-off and recoupment are by no means the same defense. * * * The latter is not statutory, but a principle of the common law, by which the defendant may reduce the plaintiff's claim, even to the extent of cutting it out entirely, by showing that, by reason of the plaintiff not complying with the obligation resting on him by virtue of the contract or transaction sued on, loss or injury has occurred to the defendant." Merchants' Bank v. Acme Lumber & Mfg. Co., 160 Ala. 435, 49 So. Rep. 782, 784. See also Waterman Set-Off, Recoupment and Counterclaim 2nd Ed., Section 464.

The jurisdiction to consider the defense of recoupment is not peculiar to courts of equity; nor is the right of recoupment interposed as a defense dependent upon the prior determination of the amount for which recoupment is asked. The defense has frequently been upheld in ordinary actions at law. Likewise, it has been held in cases where one or

both of the claims in issue were for amounts determined only in the proceeding in which recoupment was interposed as a defense.

## CONCLUSION.

The Respondent is merely asking that well established principles be applied to prevent the exaction of a debt it does not owe, and which is barred from refund if such exaction is permitted. The Commissioner erred in determining a deficiency for 1936, which error the Board should have corrected on redetermination, as the Circuit Court of Appeals decided.

Respectfully submitted,

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and
D. M. KELLEHER,
*Attorneys for Respondent.*

October, 1943.

## APPENDIX.

Revenue Act of 1934, c. 277, 48 Stat. 680, provides:

Sec. 272. PROCEDURE IN GENERAL.

(a) (1) Petition to Board of Tax Appeals.—If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this chapter, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day), the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. • • •

• • • • • • • • • • •

(b) Collection of Deficiency Found by Board.—If the taxpayer files a petition with the Board, the entire amount redetermined as the deficiency by the decision of the Board which has become final shall be assessed and shall be paid upon notice and demand from the collector. No part of the amount determined as a deficiency by the Commissioner but disallowed as such by the decision of the Board which has become final shall be assessed or be collected by distraint or by proceeding in court with or without assessment.

• • • • • • • • • • •

(e) Increase of Deficiency After Notice Mailed.—The Board shall have jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount of the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any penalty, additional amount or addition to the tax should be assessed—if claim therefor is asserted by the Commissioner at or before the hearing or a rehearing.

• • • • • • • • • • •

(g) Jurisdiction Over Other Taxable Years.—The Board in redetermining a deficiency in respect of any taxable year

shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

Revenue Act of 1926, c. 27, Sec. 1003 (a) and (b), 44 Stat. 110, provides:

Courts of Review.—(a) In General. The Circuit Courts of Appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board, * * *

* * * * * * * * * * *

(c) Powers—(1) To affirm, modify, or reverse. Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.

# SUPREME COURT OF THE UNITED STATES.

No. 53.—October Term, 1943.

Commissioner of Internal Revenue, *vs.* Gooch Milling & Elevator Company. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[December 6, 1943.]

Mr. Justice Murphy delivered the opinion of the Court.

The jurisdiction of the Board of Tax Appeals[1] to determine and to apply a prior tax overpayment against a tax deficiency for a particular year is the sole question presented by this case. The Board held that it did not possess such jurisdiction, but the court below reversed, 133 F. 2d 131. We granted certiorari, 319 U. S. 737, the problem being one of importance in the administration of the revenue laws.

An audit made in 1938 of the books of the respondent corporation disclosed an erroneous valuation of its inventory of June 30, 1935.[2] Because of this error, respondent had been overassessed and had overpaid its income and excess profits taxes for the 1935 fiscal year. This excess payment was not subject to refund because barred by the statute of limitations. On the basis of the adjusted inventory, however, the Commissioner determined that there was a tax deficiency for the 1936 fiscal year. The overpayment of the prior fiscal year exceeded the amount of this deficiency. On appeal to the Board for a redetermination of the deficiency, the respondent sought in its amended petition to have the 1935 overpayment applied as an offset or recoupment against the 1936 deficiency. The

[1] Section 504(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, 957, changed the name of the Board of Tax Appeals to The Tax Court of the United States. Section 504(b) provided that this change in name was to have no effect on the jurisdiction, powers and duties of the agency. See also H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 172-173.

[2] The respondent filed its tax returns on the basis of a fiscal year ending on June 30. The inventory of June 30, 1935, was common to successive years, being the closing inventory for the 1935 fiscal year and the opening inventory for the 1936 fiscal year.

Board, consistent with its past decisions,[3] refused to grant this relief "for jurisdictional reasons."

We hold that the Board's position was correct and that it had no jurisdiction to determine or to apply any overpayment of the taxes for the 1935 fiscal year against the 1936 deficiency.

The Board is but "an independent agency in the Executive Branch of the Government,"[4] and the legislative pattern of its jurisdiction is clear and unambiguous. The Board is confined to a determination of the amount of deficiency or overpayment for the particular tax year as to which the Commissioner determines a deficiency and as to which the taxpayer seeks a review of the deficiency assessment. Internal Revenue Code, §§ 272, 322(d). It has no power to order a refund or credit should it find that there has been an overpayment in the year in question. *United States ex rel. Girard Trust Co.* v. *Helvering*, 301 U. S. 540, 542. Section 272(g) of the Internal Revenue Code specifically provides that "the Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid."

The Board's want of jurisdiction to apply the doctrine of equitable recoupment in this case is manifest from these statutory provisions. The Commissioner assessed a deficiency only for the 1936 fiscal year and it was this assessment of which the respondent sought a review. The Board thus had jurisdiction to do no more than redetermine the 1936 deficiency distinct from any overpayment or underpayment in any prior or subsequent year. There was no occasion here for the Board to exercise its power under § 272(g) to consider any facts relating to the taxes for the 1935 fiscal year.[5] The redetermination of the tax liability for the 1936

[3] See, for example, Appeal of R. P. Hazzard Co., 4 B. T. A. 150; Appeal of Cornelius Cotton Mills, 4 B. T. A. 255; Appeal of Dickerman & Englis, Inc., 5 B. T. A. 633; B. T. Couch Glue Co. v. Commissioner, 12 B. T. A. 1321; Gould-Mersereau Co., Inc. v. Commissioner, 21 B. T. A. 1316; Heyl v. Commissioner, 34 B. T. A. 223; Red Wing Potteries, Inc. v. Commissioner, 43 B. T. A. 841; Elbert v. Commissioner, 2 T. C., No. 113.

[4] 53 Stat. 158, 26 U. S. C. § 1100.

[5] The Board has not hesitated to exercise its jurisdiction under § 272(g) to consider the taxes for other taxable years insofar as relevant to the correct redetermination of the deficiency in question. See Evens & Howard Fire

fiscal year was in no way dependent on any prior tax assessment or overpayment. Likewise, neither the fact that the prior overpayment could no longer be refunded nor the fact that the overpayment exceeded the amount of the deficiency had any relevance whatever to the redetermination of the correct tax for the 1936 fiscal year. The respondent, in other words, was seeking to have the 1935 overpayment used, not as an aid in redetermining the 1936 deficiency, but as an affirmative defense or offset to that deficiency.[6] This necessarily involved a determination of whether there was an overpayment during the 1935 fiscal year. The absolute and unequivocal language of the proviso of § 272(g), however, placed such a determination outside the jurisdiction of the Board. Thus to allow the Board to give effect to an equitable defense which of necessity is based upon a determination foreign to the Board's jurisdiction would be contrary to the expressed will of Congress.[7]

We are not called upon to determine the scope of equitable recoupment when it is asserted in a suit for refund of taxes in tribunals possessing general equity jurisdiction. Cf. *Bull* v. *United States*, 295 U. S. 247; *Stone* v. *White*, 301 U. S. 532. But its use in proceedings before the Board is governed by the circumscribed jurisdiction of that agency. The Internal Revenue Code, not general equitable principles, is the mainspring of the Board's jurisdiction. Until Congress deems it advisable to allow the Board to determine the overpayment or underpayment in any taxable year other than the one for which a deficiency has been assessed, the Board must remain impotent when the plea of equi-

Brick Co. *v.* Commissioner, 8 B. T. A. 867; Commercial Trust Co. *v.* Commissioner, 8 B. T. A. 1138; D. N. & E. Walter & Co., Inc. *v.* Commissioner, 10 B. T. A. 620; J. C. Blair Co. *v.* Commissioner, 11 B. T. A. 673; Greenleaf Textile Corp. *v.* Commissioner, 26 B. T. A. 737, affirmed 65 F. 2d 1017; W. M. Ritter Lumber Co. *v.* Commissioner, 30 B. T. A. 231, 277.

[6] As we said in Bull *v.* United States, 295 U. S. 247, 262, "recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded."

[7] Before § 272(g) of the Internal Revenue Code was enacted, the Board held that it had jurisdiction to determine an overpayment for a year as to which no deficiency had been found by the Commissioner and to apply that overpayment against the liability for the year as to which he had found a deficiency, thus giving effect to the doctrine of equitable recoupment. Appeal of E. J. Barry, 1 B. T. A. 156. Soon thereafter, however, Congress passed § 274(g) of the Revenue Act of 1926 [now § 272(g) of the Internal Revenue Code] taking such jurisdiction away from the Board.

table recoupment is based upon an overpayment or underpayment in such other year. The judgment of the court below is therefore reversed and that of the Board of Tax Appeals is affirmed.

***Reversed.***

A true copy.

Test:

*Clerk, Supreme Court, U. S.*